

CA

magazine

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August 2009

www.camagazine.com



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Staying alive

In tough economic times, CAs can help SMEs not only to survive but to thrive by seizing opportunities

“What a difference 12 months made,” writes John Lorinc in “Staying alive” (p. 26), one of two feature articles in this edition devoted to small and medium enterprises and how CAs work with and for them. When CAmagazine was planning this issue last fall, things were not so bad. The financial markets were in crisis, but the situation was not yet what pundits label the “real economy.” So the plan was to have articles on how to grow a business, how to hire and retain staff, etc. Yes, what a difference 12 months made. We changed the focus of the issue to reflect the new economic reality.

Lorinc’s words refer to the situation at The Brick Group Income Fund. In March 2008, the company announced that 2007 had been its best year ever. A year later, it had gone through all but \$10 million of its main operating line. Two months later, company officials revealed their financial restructuring plan. Through the experience of The Brick and other firms, the article looks at restructuring strategies when a situation gets intolerable.

For our other feature, writer Yan Barcelo talked to SME owners and managers and identified the services they most value from their accountants. The result is “Ten ways to add value” (p. 20). Knowing what services clients value is interesting enough, but the article also reveals the importance of CAs for these businesspeople, who consider them heroes “who fight for entrepreneurs against the multi-headed monsters of fiscality, government regulation and foreign competition.”

Our June/July issue was dedicated to the transition to IFRS and the race to meet the January 1, 2011, deadline. Two months have passed and things haven’t improved, according to various surveys and discussions heard at the Financial Executives International Canada annual conference in Montreal, where IFRS-related workshops and seminars drew the most participants. This month’s Transition to IFRS Regular (“Just a few months to go,” p. 32) should be of particular interest. In addition to this piece, our Regulars section offers articles on taxation (“Obama’s proposals,” p. 37), assurance (“Changes ahead,” p. 40) and technology (“Applying IT controls,” p. 43).

Finally, in his Netwatch column, Jim Carroll talks about the importance of a brand and of keeping it relevant and current (“Don’t be a one-night brand,” p. 12). And Marcel Côté reminds readers that Canada’s productivity lags behind that of the US and suggests that governments should review their strategies to stimulate innovation, which he describes as too R&D-centric (“Productivity and innovation,” p. 52).



Christian Bellavance, Editor-in-chief

PAUL ORENSTEIN

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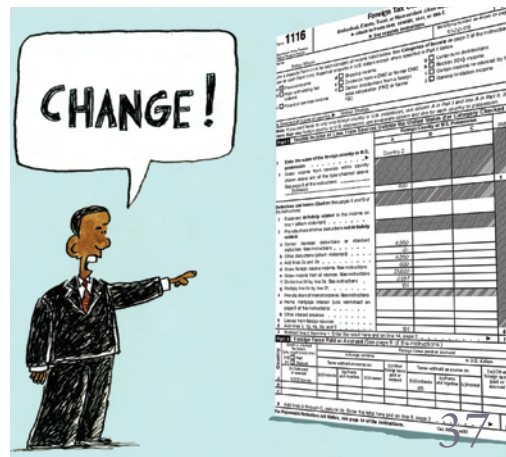
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Mailbox

A DOSE OF REALITY

I read Marcel Côté's comments on his portfolio woes ("A dose of humility," May) with interest. I have been in the advice-giving business 15 years and did not enjoy the market activity of 2008 and early 2009 either. However, before throwing out modern finance considerations in portfolio construction theory, I would direct you to a forum (www.dimensional.com/famafrench/2009/03/qa-confidence-in-the-bell-curve.html#more) where the work of Nassim Nicholas Taleb and Benoît Mandelbrot are briefly discussed (by Eugene Fama and Kenneth French).

The dimensions of risk and resulting headaches when real risk (on the downside) appears are such that we all want to plan for and control that risk. Which by its very nature is not realistic. It is through the endurance of risk that we anticipate higher returns. With realistic balance and diversification, portfolios can survive such times and owners and beneficiaries of those portfolios can continue their lives without undue financial distress.

The market turmoil of 2008-2009 will likely serve to bring our expectations back to reality and act as a shrinking ray to many a bruised ego.

Daryn G. Form, CFP
Saskatoon

Marcel Côté's reply:

Thank you for your note. Eugene Fama was a student of Benoît Mandelbrot, as Nassim Nicholas Taleb was, at Yale. I guess Fama and Mandelbrot disagreed later on, as Fama relied very much on the Gaussian (normal bell curve) distribution hypothesis to develop most of his work.

You can read more about Mandelbrot on Wikipedia. I also suggest you buy his latest book (*The (Mis)Behavior of Markets: A Fractal View of Risk, Ruin and Reward*, by Mandelbrot and Richard L. Hudson;

Basic Books, 2004), which definitely inspired Taleb and also should have been read by all of us before 2008.

A CLEARER VIEW

For years I have pursued vigorous physical activities, including running marathons and hiking China's Great Wall. None fully prepared me for the rigours of trekking Mt. Kilimanjaro. While I expected self-satisfaction — despite ending my quest 4,000 feet shy of the 19,000-ft. peak — I didn't expect to gain insights into my profession as an auditor and fraud examiner.

One of the 10 generally accepted auditing standards is the need for technical training and proficiency. These are analogous to the need for aerobic and strength training in anticipation of scaling a mountain. Another factor, due professional care, must be observed during an audit or fraud examination. In mountaineering, a failure to exercise due care can be deadly.

A core requirement throughout the engagement in auditing and fraud examination is planning. This is also true in mountaineering, as one must be alert to the need to change course as conditions change.

Mountaineering requires both physical and mental endurance. Auditing and fraud examination demand the same mental toughness. Adhering to a detailed, industry-relevant audit program parallels the "one step at a time, one day at a time" approach to climbing.

Communication with team members can't be overemphasized in mountaineering. As guides constantly remind trekkers to go "polepole" (Swahili for slowly), they must also ensure none has fallen behind because of fatigue or altitude sickness. In an audit or fraud investigation, a partner or manager must establish a clear vision of the engagement's objectives and strategies and ensure that even junior assistants feel comfortable raising issues of concern.

Environmental conditions play a determining role in climbing. Audit plans are also subject to change. Initial assessments of inherent and controlled risks must be understood to be tentative.

As noted, despite peer pressure, I elected not to attempt the final ascent due to my assessment of risk. Independence is the hallmark of our profession and one of its core ethical standards. Despite well-publicized lapses by a few, public accounting can take pride in its adherence to ethical standards. Climbing Mt. Kilimanjaro brought that into renewed focus for me. The view from near the summit let me see my everyday work more clearly than ever.

Susan Cheng, CA
Chicago

95% VERSUS 50%

I agree with the theory in Paul Cherry and Ian Hague's article "Fair values: when the engine overheats, don't blame the oil light" (News from the profession, June/July). It would be great if financial statements presented the fair value of all assets and liabilities of a company. I recall that in the early '80s the profession considered the value of presenting financial statements that also predicted the future. This would be better than presenting the fair value at the balance sheet date.

The problem is that for financial information to be useful it must be accurate and verifiable. Information presented must be done in a way that provides a high level of confidence in its accuracy while allowing an auditor to form an independent opinion on the accuracy.

We must be diligent in not overstating the reliability of information we disclose and audit. As a user of financial statements, I would be more comfortable knowing with 95% confidence what an asset cost than knowing with 50% confidence what it might be worth on a given date.



Mailbox

I wonder if we are kidding ourselves when we form an opinion that financial statements are not materially misstated when many fair-value calculations would result in materially different results given fairly small changes in assumptions.

In a car, the oil light goes on when the oil is low. Would you buy a car if the manufacturer was only 50% confident the dashboard instruments were accurate?

Barth Bradley, CA

St. Albert, Alta.

Ian Hague's reply:

Barth Bradley is correct that a number of factors have to be taken into account in assessing how best to measure an item in financial statements. These include verifiability and reliability and other factors such as relevance, understandability, comparability and timeliness, as well as cost constraints. In addition, it is difficult to represent an item solely by the number on the face of the financial statements — additional disclosures are required to provide additional information about the underlying assumptions and possible variability of the number on the face of the financial statements.

That said, the number on the face of the financial statements should be that which maximizes the underlying characteristics — of which a key one is relevance to decisions made by financial statement users. Users have repeatedly expressed their preference for current information. I would rather buy a car with an oil light that had a 50% chance of being accurate than one that simply told me how much oil I originally put into the engine.

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UPFRONT

News, people, briefs, trends + tips

Hot property



Arthur Caplan's CA background puts Toronto's first-time home buyers at ease, making him a realtor to reckon with

To put it in real estate sales lingo, Arthur Caplan's CA designation shows beautifully. The top-performing realtor, who specializes in tony Toronto neighbourhoods, credits his CA credentials for giving him an edge in the city's fast-paced housing market, where clients are often making the biggest financial decisions of their lives. "Whether it's an ad in the paper or my business card, everything says CA," says Caplan, 64. "People quickly came to realize that I wasn't just a salesperson, that I had a brain too."

Indeed, Caplan's experience shows that he's not your average salesman. After working in public practice for seven years, the Toronto native was a controller for a privately owned pipe maker, and later became a successful entrepreneur as co-owner of Jac-An Formals Ltd., manufacturing bridesmaids dresses, wedding gowns and cocktail dresses for retailers across Canada. He eventually sold his share of the business for the freedom of a career in real estate, obtaining his licence in 1990, shortly after a lengthy housing boom went bust.

In his first year Caplan earned just \$4,340, a shock for a sole breadwinner with four young children, a mortgage and recently purchased hobby farm. He struggled to earn a living for the first three or four years before creating a winning formula for first-time buyers with his CA training and reputation for straight, honest talk, which has spurred many referrals.

Today, still an accountant at heart, Caplan can tell you how many houses he has sold over the years (645 according to his meticulous columnar pad records). In February, his firm Chestnut Park Real Estate Ltd. gave him the 2008 Chairman's Award for outstanding sales (he moved nearly \$19 million in real estate), as it has every year since he joined the company in 2005. Paul Brent

Résumé

- 1971** obtains CA designation (Ont.)
- 1974** hired as controller, Dom-x Plastics Ltd.
- 1980** becomes co-owner of Jac-An Formals
- 1990** obtains real estate licence
- 2005-'09** receives Chestnut Park's Chairman's Award for outstanding sales

CAmag is best-in-class

CAmagazine won more prizes than any other publication, including the top award for Best issue, at the 2009 Kenneth R. Wilson Awards, which recognize excellence in the Canadian business press.

In addition to two gold and five silver awards (see below), CAmag received six top-five and seven top-10 honourable mentions.

- **Gold - Best issue**
Boosting the bottom line (May 2008)
- **Gold - Best illustration**
From there to here (June/July 2008)
- **Silver - Best professional article**
Good guys finish first (May 2008)
- **Silver - Best merchandising/marketing article**
Positioned to win (October 2008)
- **Silver - Best regularly featured department or column** Outlook
- **Silver - Best photograph**
Soul practitioners (October 2008)
- **Silver - Best art direction of a complete issue** The financial planning issue (November 2008)

BALANCE OR BUST

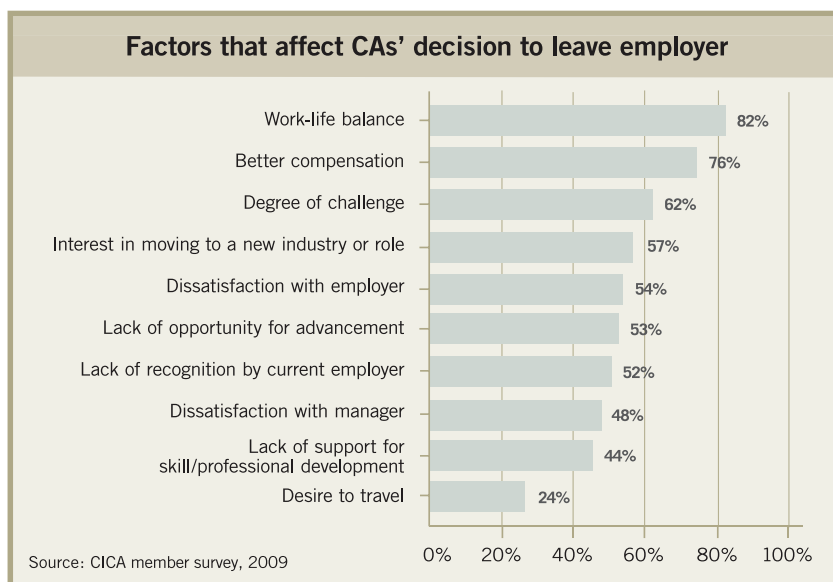
Employers looking to retain CAs should pay attention to the level of flexibility they offer staff. In a recent CICA member survey, 96% of CAs said work-life balance is important to them. Nearly 20%, however, are dissatisfied with their current level of work-life balance.

Furthermore, 82% of CAs surveyed said work-life balance would play into their decision to leave their employer. Other factors that would affect respondents' decision to leave their current job include better compensation (76%), degree of challenge (62%), interest in moving to a new industry or role (57%), dissatisfaction with employer (54%), lack of opportunity for advancement (53%) and lack of recognition by current employer (52%).

The survey also asked respondents to define work-life balance. The most frequently cited definitions were time with family/ful-

filled home life (52%), time for nonwork-related activities (37%) and maintaining a successful and challenging career (35%).

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



ASK AN EXPERT

IS IT A BAD TIME FOR SMEs TO ENTER FOREIGN MARKETS?

Even in challenging economic times, Canadian businesses understand that their future lies not in retreating into our home market but in looking beyond our borders for growth opportunities. Entering new offshore markets under current economic conditions may entail additional risks, so businesses should follow these steps:

Do your homework. Understanding the country, currency and payment risk is more important than ever. The recent economic challenges have forced some foreign buyers and suppliers to change the levels of required guarantees of credit now needed to ensure transactions get completed.

Choose your bank carefully. Many banks do not have a presence in the countries where you may want to operate and this can complicate financial transactions or mean missed opportunities.

Stay up to date. Prepare for the financial risks of small business exports in advance and under-

stand the changing economic and political dynamics in the countries in which you plan to operate.

Review import contracts. Importing to Canada also represents risks to small business. A bank can assist with import letters of credit, import documentary collections, shipping guarantees or airway bill releases and import financing. Set up these facilities well in advance; even your traditional foreign business suppliers may soon be asking for new types of financial guarantees based on changes to their own banking requirements.

Don't ignore your existing business. Establishing relationships with buyers and sellers in foreign markets takes time, effort and money — which can distract you from running your day-to-day business. Stay focused on your international business goals without jeopardizing your existing business.

Jon Hountalas is executive VP of commercial banking at HSBC Bank Canada (www.hsbc.ca)

#NUMBERS Game

1.3 Millions of Canadian small businesses without an employee on the payroll.

3:2 Ratio of Canadian small-business owners who expect to hire more workers in 2009 to those expecting fewer on the payroll. The Small Business Research Board noted in February that 29% of businesses believe they will add staff this year.

4 Factor by which an employee at a firm in Canada with at least 500 employees is more likely to have a company pension than someone at a business with fewer than 20 workers, according to a 1998 study by Statistics Canada.

6 Number out of every 10 Canadian small businesses that employ family members, according to a 2007 Canadian Federation of Independent Business (CFIB) study.

Small business. Big sector Firms with fewer than 50 workers employ an estimated 4.3 million employees nationwide. That's one out of every three Canadian workers



11.4 Percentage of independent small businesses whose staff completed an employee feedback survey in 2004, according to a Statistics Canada study on management practices.

17.3 Cents on the dollar more earned by federal government employees compared with private-sector workers in equivalent jobs. In 2008, the CFIB said the wage gap was driving up costs for Canada's private-sector firms and making it harder for them to find workers.

43 Percentage of Canadian small-business owners who spend time fixing mistakes in payroll administration, according to a 2006 study. The survey also found more than one in 10 paid late penalties for not filing paperwork on time.

Steve Brearton

Going Concern



RAHUL MEHTA, CA
OWNER & PRESIDENT
GOLF CLEARANCE WAREHOUSE

COMPANY PROFILE: Markham, Ont.-based Golf Clearance Warehouse buys golf gear — clubs, bags, balls, carts and clothing — from retail and pro-shop closeouts, bankruptcies and inventory overruns and sells the equipment at 30% to 60% less than regular retail prices. With six locations in the Toronto area, along with web sales, it's the third-largest golf chain store in Canada, employing more than 40 people. Its primary target is the entry to midrange market, the "blue-collar golfer who doesn't necessarily need the latest and greatest," says Mehta, who has owned the company since 2005. Its profit has grown a minimum of 20% every year since 2001.

HOT FACTOR: From its 24,000-sq.-ft. facility in Markham, where it cleans and repackages up to 100,000 used golf balls a week, Golf Clearance Warehouse is recognized

as the largest recycled golf-ball retailer in Canada. It's big business: with most golfers losing an average of four balls per round, the chain sells about 10 million golf balls every year. "It's our bread and butter," says Mehta.

COOL PROJECTS: While continuing to expand the company's reach in the southern Ontario market — financing its growth entirely from profits — Mehta is also hoping to establish a franchise model to expand both in and beyond the province. The company also launched an offshoot, GolfClient Services, which manages the marketing, administration and logistical tasks for corporate golf events.

IN HIS OWN WORDS: "Our goal is to outfit a golfer with everything he needs, from the clubs to the shoes to the bag to the balls to the tees, and get him on the course by spending less than \$500, rather than a typical outlay of around \$1,500. Golf shouldn't be a rich man's game."

John Shoesmith



Wake-up call for managers

Supervisors may think they know how to reward a job well done, but new research suggests they aren't hitting the mark with support staff. In a study developed by temp service OfficeTeam and the International Association of Administrative Professionals, managers rated job promotions and cash as the two forms of recognition their staff most value. The admin professionals, however, actually favoured a simple thank-you or having their accomplishments passed on to senior management.

The study also showed how important recognition is in attracting and retaining staff, even in a soft economy. Two out of three admin staff polled said they would likely leave their job if they did not feel appreciated by their manager, while 70% said the company's recognition program would factor into their decision to accept a job with a potential employer.

"While financial rewards should not be overlooked, praise from supervisors or colleagues that is specific, immediate and genuine can go a long way toward keeping these employees motivated and loyal," says Robert Hosking, executive director of OfficeTeam.

Home advantage

Canadian companies could save \$50 billion a year by encouraging people to work at home, according to a recent telecommuting study. Vancouver digital media company MakeGood and San Diego think-tank Telework Research Network crunched the numbers using 2006 Canadian census data and more than 250 studies to assess the impact telecommuting could have on the Canadian environment, companies' bottom lines and employees. It found only 7.7% of about 16 million Canadian workers currently telecommute, but 5.2 million more could. This would allow companies to save 46 million barrels of oil, avoid the production of nine million tons of greenhouse gas, gain access to a broader workforce, increase productivity, and enjoy reduced real-estate costs, absenteeism and turnover, the study finds.

Gratitude gulf

Forms of recognition valued most by administrative professionals, as ranked by managers and support staff

Managers	Administrative professionals
1. Promotion	1. In-person thank-you (tied for first)
2. Cash	1. Boss shares achievement with senior management (tied for first)
3. Paid time off	3. Promotion
4. Boss shares achievement	4. Membership to a professional association with senior management
5. In-person thank-you	5. Registration for a conference or seminar

Source: OfficeTeam, 2009

STANDARD DECISIONS

One in four leading Canadian private companies plans to adopt IFRS, rather than the proposed made-in-Canada private company GAAP, according to a KPMG Enterprise-FEI Canada study. All private companies in Canada must adopt either IFRS or the new Canadian standard by 2011.

THANKS MOM

Working mothers in Canada would earn an extra \$83,863 if paid for all their "mom" duties, a Salary.com poll finds. The "mompensation" is a weighted average of the jobs/salaries that best match 12,000 mothers' definitions of their work — including janitor, driver, housekeeper, computer operator, cook, daycare teacher, psychologist and CEO.

MORE TRAINING PLEASE

Nearly eight in 10 Canadian workers think their skills will be outdated within five years, according to a survey by staffing firm Kelly Services. More than a third of the 7,000 Canadians polled say the training their employers now provide won't meet their future needs, and 47% say their employers haven't helped them reach their career goals.

Reputation risk management on the rise

A growing number of major global companies are investing substantial resources to manage their reputation risk, according to a new report from the Conference Board in the US. They have also stepped up their efforts in this area over the past three years.

The report, which is based on the findings of the Conference Board's Reputation Risk Research Working Group and a survey of 148 executives, notes that 82% of respondents said their companies are making a substantial effort to manage reputation risk.

"Safeguarding reputation is even more critical today because companies have developed successful ways to make reputation risk management part of their overall risk management," says Ellen Hexter, director of enterprise risk management at the Conference Board and co-author of the report with Sandy Bayer, president of Bayer Consulting. "In addition, different stakeholder groups are becoming more sophisticated in how they drive corporate reputations. Critics on the Internet can now transmit their opinions ... with ease."

Among other key findings, the study showed that:

- only 49% of executives surveyed said the management of reputation risk was highly integrated with their

enterprise risk management function or another risk oversight program;

- media monitoring has become more sophisticated; today, there are tools to assess the credibility of publications, the prominence of coverage and whether it is positive, neutral or negative;
- there are efforts to quantify the value of reputation;
- although consumers and investors are gathering information from blogs and social networking sites, only 34% of the respondents monitor such sites extensively.

In response to the findings, the working group made some recommendations, one of which was to involve boards in reputation risk management. "Boards of directors, senior management and operating management should demonstrate an active commitment to strong reputation management," say the authors. "While crises are sometimes inevitable, a company's reputation when it is most vulnerable and how the organization responds can have an enduring impact on how it is perceived for years to come."

For an expanded article in which Ellen Hexter expands on the study's findings and recommendations, visit www.camagazine.com/reputationrisk.

Private company GAAP and CFOs

This spring, the Canadian Accounting Standards Board released its made-in-Canada private company GAAP option for private companies that choose not to adopt IFRS (see "Private matters," *CAMagazine*, May 2009, p. 20). The new standards are expected to be available for early adoption for fiscal years ending December 31, 2009.

Some private company financial executives applaud the simplification of rules that were arguably overly complex and irrelevant for private companies. Others are concerned the made-in-Canada option might make it more difficult for senior financial executives to transfer their skills between private and public companies.

A recent survey conducted jointly by KPMG Enterprise and the Canadian Financial Executives Research Foundation suggests that the more private company GAAP diverges from IFRS, the more challenges private company CFOs may have in obtaining a position in publicly listed companies. This divergence might also make it more difficult for private companies to attract new talent. One executive said, "If you are using a less sophisticated

GAAP standard in a private company, it might lead candidates to choose employers that use IFRS."

While on the surface none of this appears to paint a rosy picture for private company accounting departments, all is not lost. The change underscores the need for continuous professional development on the part of private company CFOs and accounting professionals in general, in order to maintain flexibility in their careers. Going forward, the CFO's role will continue to be that of chief financial strategist, requiring skills beyond simply understanding technical accounting requirements. These skills will continue to be transferable across all companies.

For an expanded article, visit CAMagazine.com/privatecompanygaap.

Ramona Dzinkowski, MA, ABD, is the executive director of the Canadian Financial Executives Research Foundation (CFERF), the research institute of FEI Canada.

Robert Young, FCA, is a partner in the national assurance & professional practice of KPMG Enterprise.



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Netwatch

BY JIM CARROLL

YOUR GUIDE TO BUSINESS & ACCOUNTING ON THE INTERNET

Don't be a one-night brand

When you travel like I do, you spend a lot of time reading. One of the recent books on my list provides a fascinating look back at the 1950s and '60s: *Mr. Playboy: Hugh Hefner and the American Dream*. (No, I didn't buy it for the pictures, because there are very few.)

I was struck by one paragraph about how Hef worked very hard in the early years to get advertisers on side. He was initially met with resistance, for obvious reasons, but persisted and eventually succeeded in signing up some of the "leading brands of the time."

Just what were those brands? Crosswinds House beach towels, Scintilla Satin Bedsheets, Lektrostat Kit record cleaners, Mansfield Holiday II 8-mm cameras, Leslie Record Racks, Electro-Voice Musicaster loudspeakers, the Ronson Electric Shaver, Max Factor crew-cut hair dressing and the Rogers "Rocket Flame" cigarette lighter. And let's not forget Merrin Gold Jewelry and the Batch Book, "a new and modern address book that lets you list every pertinent detail — the surest way to avoid social errors."

Those brands aren't exactly household names today; in fact, very few of them still exist. Some disappeared due to changing societal norms, others due to technological change. Some probably just ran out of steam.

Brands disappear for a variety of reasons: think Enron, E.F. Hutton and Woolco. Brands can also stick around and become tarnished, losing respect in the eyes of the customer because of a series of missteps. My own client list includes organizations such as Chrysler, Motorola and the US Army Corps of Engineers — brands that for a variety of reasons have lost respect in the marketplace.

Is your brand at risk? That's a key question, because corporate brands today can disappear because of obsolescence, competition and business model change, or simply, as we have seen of late, failure and error. Brands now also have to contend with the potentially lethal challenge of social networks. Pizza chain Domino's quickly discovered how much harm social-network "terrorism" can do to a brand when employees posted a damaging video on YouTube in which they were less than reverent with customers' food.

It isn't just the risk of events like this that threaten a brand. People are extremely busy chatting online — on Twitter, Facebook and elsewhere — about the brands that they like and the ones they dislike. Consider the effort one customer put into a self-created commercial for US-based grocery store Trader Joe's.

All of a sudden, organizations are discovering a reality I've been pointing out for years: a brand is no longer what you say it is — it's what they say it is.

Think about your brand, whether you are in public practice, consulting or the corporate sector. Does it still resonate? I talk to my clients about the need for constant brand innovation and challenge them to ask themselves if their brands are from the "olden days." Better yet, I ask them if their brand looks tired because it is tired.

Accountants don't spend much time thinking about branding, but it is becoming more important considering how quickly perceptions can change. Here's how you should challenge your thinking.

- Recognize that brand longevity is a critical issue.
- Ensure that everyone in the organization is relentlessly focused on the currency of the brand.
- Make sure that continuous brand innovation is part of your corporate mantra.
- Be incessantly focused on the innovations that are most likely to impact your brand.

Jim Carroll, FCA, is a well-known speaker, author and columnist. Reach him at jcarroll@jimcarroll.com or log on to his website at www.jimcarroll.com

BRAND OR FALL

BrandlandUSA's 100 Dead Brands To Bring Back <http://brandlandusa.blogspot.com/2007/07/brandlandusas-100-dead-brands-to-bring.html>

Domino's CEO response www.youtube.com/watch?v=7I6AJ49xNSQ

Trader Joe's customer video www.youtube.com/watch?v=OdB7GDZY3Pk&eurl



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New accounting standards for private enterprises coming soon

After three years of research, consultation and deliberation, the Accounting Standards Board (AcSB) will soon be making available *Generally Accepted Accounting Principles for Private Enterprises*.

These new standards have been developed to meet the needs of private enterprises. They will be effective for annual financial statements relating to fiscal years beginning on or after January 1, 2011, and early adoption is permitted.

The exposure draft's comment period has closed and the AcSB is currently reviewing comments. The board hopes to issue the final standard in time for use for 2009 calendar year-end financial statements.

Entities considering adopting the new standards for 2009 periods should review the posted exposure draft at www.acsbcanda.org/edpegaap in preparation for using this new basis of accounting.

The proposed standards are built from the existing *CICA Handbook—Accounting*. Change on recognition and measure-

ment issues is limited to areas of most concern to stakeholders, most notably: financial instruments; employee future benefits; asset retirement obligations; internally developed intangible assets; impairment testing for goodwill and other intangible assets; and stock-based compensation.

Other major changes include elimination of EIC abstracts (guidance from certain abstracts has been incorporated into the body of the standards); deletion of sections and guidelines thought to be generally irrelevant to this sector; and a total refocus of disclosure requirements. The new standards focus on information required by users of a private enterprise's financial statements and reduce the number of specific disclosure requirements by approximately half compared with the existing *Handbook*.

The standards will be available to any private enterprise. No size threshold or other barriers, such as unanimous consent by shareholders or other users, will be imposed.

Updates on any significant changes to the standards will be made public on the AcSB website (www.acsbcanda.org) through AcSB Decision Summaries.

Quality control comes into effect December 15, 2009

On December 15, 2009, a new quality-control standard will come into effect for all firms providing assurance services in Canada.

CSQC 1: *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance Engagements* replaces the existing standard, GSF-QC or *General Standards for Firms Performing Assurance Engagements*. The new standard introduces a robust system that will benefit public accounting firms by allowing them to demonstrate a strong commitment to quality.

The new standard addresses the policies and procedures firms must put in place to establish and maintain a system of sufficient quality control to meet professional, legal and regulatory requirements. It outlines the necessary steps to provide reasonable confidence that all assurance reports issued are appropriate given individual circumstances.

CSQC 1 and GSF-QC are similar in many ways, and there-

fore most quality-control policies and procedures already established by firms in compliance with GSF-QC still apply when CSQC 1 comes into effect.

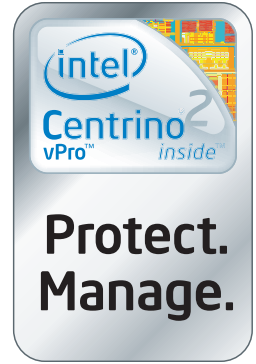
There are two noteworthy differences: first, engagement quality-control reviews must be done prior to the audit report date. Second, persons performing the engagement and the engagement quality-control review cannot inspect the engagement.

Another important aspect of CSQC 1 is that it only applies to assurance engagements (i.e., audits and reviews). This represents a significant deviation from ISQC 1, which extends beyond audits and reviews to also include related services such as Notice to Reader.

All Canadian firms that perform audits or reviews must have a quality-control system that complies with CSQC 1 in place by December 15, 2009. The time to begin preparing and planning is now. Visit www.cica.ca/cas to learn more about getting ready.

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Toolkit helps SMBs navigate through the credit crunch

A sold-out breakfast event hosted by the Toronto Board of Trade served as the official launch of a new toolkit designed to help owners of small and medium-sized businesses better understand available financing options.

The Canadian Institute of Chartered Accountants and the Business Development Bank of Canada have teamed up to produce *The Financing Toolkit for Small & Medium Businesses*.

Written by Gary A. Fitchett, CA, the toolkit provides a step-by-step strategy to help business owners secure financing, including straightforward information on banks, term loans, equity financing, mezzanine debt, government programs, leasing, factoring, and much more — how they all work and what is best for a business.

“Small and medium-sized businesses drive much of the economy, yet many are unable to get the financing they need to succeed,” says Cairine Wilson, CICA’s vice-president of member services. “The goal of the toolkit is to help SMBs tap into the many sources of financing that are available and to provide them with practical advice to navigate



Gary A. Fitchett, author of a new toolkit to help SMB owners

in today’s challenging economic climate.”

Additional information about *The Financing Toolkit for Small & Medium Businesses*, including how to order a copy, is available at www.cica.ca/financing.

Getting on track with IFRS

A survey of CICA members that was completed earlier this year shows IFRS is top of mind for Canada’s CAs. Conversion to IFRS was cited as the second most important issue facing the profession by members who responded to the January survey: 71% of respondents indicated they will require at least a basic knowledge of IFRS and 36% rated their expertise in IFRS below the knowledge required for their current job.

Those statistics could explain increased interest in IFRS professional development resources. The CICA’s annual IFRS conference, *Critical Issues in Implementation*, was sold out, with more than 250 delegates from every Canadian province attending the June event in Toronto. Delegates represented a cross section of industries and business sizes. More than 5,000 people have taken the CICA’s free online primer course, *Introduction to IFRS — Implications for Canadian Business*, and two recent IFRS webinars each attracted almost 2,500 registrants.

With mandatory adoption for more than 4,000 Canadian publicly accountable enterprises, and private enterprises invited to follow the new standards if they choose, it is difficult to gauge the overall state of preparedness. However, Gord Beal, project leader for the CICA’s implementation support strategy on the transition to IFRS and the new auditing standards, sees the increased activity as a positive sign.

“There had been concerns that affected entities, pre-occupied with the current economic situation along with rumours that IFRS might be postponed, would delay preparation,” says Beal. “The Accounting Standards Board has quelled rumours that the January 1, 2011, adoption date may be delayed. I am pleased that people understand the significance of the transition and are moving ahead. Those who have not started to plan their transition yet will need an aggressive strategy to get on track. The CICA is committed to helping IFRS adopters plan a seamless transition.”

For a complete listing of the IFRS resources available through the CICA visit www.cica.ca/IFRS.

AASB issues new Canadian Auditing Standards

The Auditing and Assurance Standards Board has adopted 36 international standards on auditing as Canadian auditing standards (CASs). It has also adopted a standard on quality control, International Standard on Quality Control (ISQC 1), as the Canadian Standard on Quality Control (CSQC 1).

Once effective, the CASs and CSQC 1 will constitute Canadian generally accepted auditing standards for audits of financial statements. All CASs are effective for audits of financial statements with periods ending on or after December 14,

2010. The quality-control standard applies to Canadian firms providing assurance services (audits and reviews) and comes into effect a year earlier (December 15, 2009).

CASs and CSQC 1 are available to be viewed through Knotia and are Part 1 of the *CICA Handbook — Assurance*. Practitioners are urged to become familiar with the new standards to prepare for adoption in the near future. Early adoption of CASs is not permitted. To learn more about making a seamless transition to CASs, go to www.cica.ca/cas.

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RECENTLY ISSUED PRONOUNCEMENTS

CICA Handbook – Accounting	Date issued†
Accounting Changes, Section 1506 (revised)	June 2009
Financial Instruments amendments to:	June 2009
— Section 3855 regarding effective interest rate and embedded derivatives	
— Section 3861 regarding application	
— Section 3862 regarding disclosure requirements	
Amendments to Section 3855 (via typescript) regarding:	
— embedded derivatives on reclassification of financial assets	June 2009
— impairment of financial assets	July 2009
EIC Abstracts	
Application of Section 3465 to Mutual Fund Trusts, Real Estate Investment Trusts, Royalty Trusts and Income Trusts, EIC-170 (revised)	July 2009

Public Sector Statements of Recommended Practice	
Indicators of Financial Condition, SORP-4	May 2009

CICA Handbook – Assurance (Part I)	
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	



RECENTLY ISSUED DOCUMENTS FOR COMMENT (to July 31, 2009)

Accounting	Comment deadline
EDI Derecognition	July 31, 2009*
EDI Fair Value Measurement	September 29, 2009*
ED Generally Accepted Accounting Principles for Private Enterprises	July 31, 2009
EDI Income Tax	July 31, 2009*
Public Sector	
SOP Entity Level Financial Statements	September 28, 2009
ED Financial Reporting by Certain Government Organizations	August 7, 2009
rED Government Transfers	September 15, 2009

Legend

ED – Exposure Draft EDI – ED issued by the IASB rED – Re-exposure Draft
 DS – Draft SORP ITC – Invitation to Comment SOP – Statement of Principles

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

* Stated date reflects the comment deadline set by the International Accounting Standards Board (IASB).

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

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To some, CAs are dull and colourless, but to SMEs, they are trusted advisers, valuable sources of information and providers of many services

by Yan Barcelo

10 **TEN** ways to add value

BLAND, BORING AND COLOURLESS are just a few of the common stereotypes that spring to mind when describing an accountant. But these are just urban myths. In the small and medium enterprise (SME) world, the accountant holds the status of a hero, one who fights for entrepreneurs against the multiheaded monsters of fiscalty, government regulation and foreign competition.

This is substantiated in a number of surveys where clients say their accountant brings a lot of value. According to a Canadian Federation of Independent Business (CFIB) study, 66.5% of companies consider their accountant — and lawyer — the most valuable source of information. Business and trade associations rank lower, at 35%, followed by other small businesses (19.8%) and suppliers (12.3%). **illustration by LASSE SKARBÖVIK**



5kaRbovik

“The accountant is the person an entrepreneur is most likely to call after a sleepless night thinking about his company”

“When family businesses are asked who their most trusted adviser is, 73% say it is their accountant,” says Lawrence Barns, CEO of the Canadian Association of Family Enterprise. “The accountant is the person an entrepreneur is most likely to call in the morning after a sleepless night thinking about his company,” he says. Entrepreneurs say they can talk to their accountants intimately and confidentially about their business because they know the numbers, the company’s direction and its goals at a level where few can delve.

Do all accountants bring value? Certainly not, says Benoît Lavigne, professor of financial accounting and researcher at the research institute for SMEs at Université du Québec à Trois-Rivières. In some cases, accountants just want to be bean counters, but the main reason for this is that many SMEs don’t require anything more than bean counting and don’t understand the full value an accountant can bring to their business.

And just what are some of the value-added services accountants can bring? While not an exhaustive list, here are at least 10 such services.

The accountant as choirmaster

Accountants essentially crunch numbers, right? Wrong. As one accounting professor at HEC Montreal used to tell his students: “A real accountant doesn’t just align numbers in rows and columns, he makes them talk. Better still, he makes them sing.” Here are three basic songs in the accountant’s repertoire.

Bean counting plus At face value, the simple preparation of financial reports could be considered a low-value service. “We could make the analogy with a physician who hands you an X-ray in an envelope, with no diagnosis,” Lavigne says. “You would have a snapshot of your bodily situation, but no idea of your health. Do I have pneumonia or just a bit of bronchitis? Can I run next week’s marathon or should I spend that time in a sanatorium? If the accountant doesn’t give a reading of the strengths and weaknesses of the company, it’s worth very little.”

If you don’t propose solutions, a diagnosis is not enough. “Does the company underutilize production capacity?” Lavigne asks. “Then it should increase sales by launching a new product line or aiming for an export market.”

But beneath the surface, the basic preparation of financial reports can involve a lot of added value. “There’s a lot of value simply in giving an SME the exact report it needs,” Lavigne says. “For example, an obvious question is: should it have reports in line with the new IFRS rules or with Canadian GAAP? What level of credibility do you need to give them: a basic notice to readers, a review engagement or a full audit report?” Just sorting out the regulatory constraints that underpin that choice implies a refined level of knowledge on the accountant’s part.

But added value lies deeper. Of course, for a majority of pri-

vate SMEs, the banker is the most important user of their financial statements. As such, an accountant can make a valuable judgment call by determining the right level of certification that will satisfy the banker and may even cost the company less. But that call can integrate still more elusive factors. “There is an increasing tendency on the part of creditors,” says Lavigne, “to ask for less sophisticated statements with lower levels of certification and to depend on lending criteria [other than the annual report], such as the company’s capacity to repay debt, the competence of the entrepreneur and the personal guarantees he can contribute.” Juggling all these factors and gauging the right type of report increasingly constitute a high-value service.

Strategic bean counting Obviously, there are levels where accounting goes beyond report preparation and reaches the heights of strategy — if not art. This is what Pierre Bélanger, president of Dagua Inc., witnessed while working with an external accounting firm. A startup firm, Dagua has attracted major investment partners with its groundbreaking self-contained water filtering station, which uses ozone rather than chemicals to make contaminated water drinkable.

With a few simple manoeuvres, the accountant changed the company’s financial position. Dagua was spending a lot of money promoting its product before it was ready to come off the production line. “We were showing heavy losses,” says Bélanger.

A seasoned businessman, Bélanger did not see how he could present more favourable statements. The accountant took advantage of special laws applying to startups to capitalize marketing expenses that were going to show results in only three or four years. “We transferred more than \$2 million in expenses and showed results that were much better aligned with our company’s position in a startup’s life cycle,” Bélanger says.

Duff Jamison, president and CEO of Great West Newspapers in Edmonton, benefited from a similar strategic input from his auditors when they were applying formulas to test if goodwill had been impaired with the recent economic downturn. At face value, a few divisions seemed to have suffered. “But formulas can’t ask why or what was the purpose in carrying out this operation,” says Jamison. “If an accountant is attuned to your business and understands your strategy, it can bring a lot of value, and that’s why our accountant was able to eliminate impairment at one of our divisions.”

Fiscal optimization The puzzles and pangs of fiscal regulation form a battleground on which accountants appear like heroes to entrepreneurs. Consider R&D credits. “Of course the company needs to keep informed on fiscal matters,” Bélanger says, “but when it comes down to the nitty-gritty of numbers, an accountant’s help can be more than precious.”

His accountant’s expertise came through when Dagua was

audited by both provincial and federal revenue agencies. "When these people started to challenge us and throw tricky numbers at us," says Bélanger, "[our accountant] was able to answer their rhetoric and show that the laws allowed us to claim many expenses. We particularly appreciated his devotion and the way he was ready to go the full distance on touchy issues."

Diagnocure, a well-established biotechnology company in Quebec City, benefited from the fiscal expertise of a large accounting firm. "During the corporate restructuring, it made a difference," says financial manager Frédéric Boivin. When Diagnocure bought a firm in the US and opened a US subsidiary to market its new diagnostic test, it faced conflicting scenarios. For example, it could incorporate the companies in the US, create limited partnerships, make one company dependent on the other, or liquidate both and control everything from Canada.

"We ended up forming a limited partnership for the company we bought out and set up a general partnership with the one we created. When the general partnership will have fulfilled its objective, it will absorb the limited one and, as profit shows up, it will be transferred to the parent company in Canada to help it cover its losses."

The company's lawyers were against the limited partnership solution because it exposed the Canadian head office to possible lawsuits originating in the US. "But the fiscal advantages our accountant unearthed won against the legal disadvantages," says Boivin.

Leaving the numbers behind

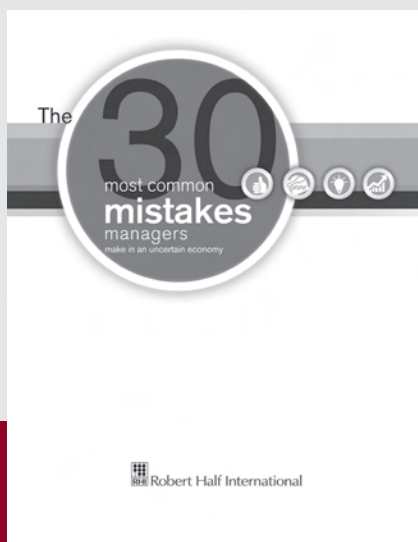
Business is not just about numbers. It's about strategic planning, making tough calls based on partial information and building markets. But because the accountant knows the numbers that underlie all these activities, his or her counsel can be extremely valuable.

Mastermind "We do a lot of strategic planning sessions with presidents and vice-presidents of clients' companies," says Yves Nadeau, an associate at RSM Richter Chamberland in Montreal. "We go over countless subjects: the most important areas where a company needs to make progress, increasing revenue, optimizing operational efficiency, opening a new line of products, making the organization chart leaner. Currently, there are lots of discussions around inventory reduction, cash generation and cost cutting." All quite remote from traditional accounting columns.

Strategic planning should be conducted every three to five years and the plan should be reviewed annually. This is where an accountant can play a key role by challenging the plan's objectives and the assumptions underlying it. For example, is it time to branch out into a new product line? Does the firm have the necessary production capacity? How will it impact client support?

But Nadeau suggests an accountant can go even further than the planning phase. "Execution is as important as planning," he says. "There's a client I work with where I act as the watchdog of the strategic process. We meet every six weeks to review what's

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“We were at a loss how to account for cash flows around real estate and sales tax inputs. Our accountant knew”

been done to implement the strategic plan. The client has formed teams around his strategic objectives and they report to us on their evolution. They are compelled to deliver results.”

The art of the deal Because you don't sell a company 25 times in a lifetime, says Nadeau, better do it well and get the best help available. In fact, he says, preparing for a sale is a long-term project. A company needs stable revenue, a well-diversified client and supplier base and it must show potential to a prospective buyer. An accountant can help on all points, and even more in highlighting the company's potential: showing synergies with the buyer and promising projects on the back burner, for example.

Another area where an accountant can play a major role is in making sure the books and the company's activities don't hold any nasty surprises. “That undermines the relationship and can be fatal,” Nadeau says.

But an accountant's greatest input is in setting a selling price for a firm. This is a sensitive area because entrepreneurs typically tend to overestimate the value of their company, says Grant Robinson, partner at Robinson & Co. in Guelph, Ont. Robinson remembers an owner who regretted refusing one fair offer. A few years later, he was forced to accept a purchase offer 50% lower.

Jamison found his accountant's expertise particularly helpful when he bought out previous partners Southam Inc. and Hollinger Inc. “These people had way more firepower than I did in negotiations and could outgun me,” says the publisher. But the presence of the senior partner from his accounting firm helped level the playing field and the terms of the deal ended up more favourable to Jamison than he had anticipated.

While an entrepreneur may sell a company only once, chances are he or she might buy a few in his or her career. To a large extent, buying is a mirror image of selling. For example, the due diligence process tries to unearth the same unpleasant surprises you want to avoid in the sale process, and you have to negotiate a fair price. But in the purchasing process, there are other considerations — how to finance the purchase, formulating clauses that will guard against hidden vices, proposals to gain management's loyalty — where the accountant's advice can be crucial. It can also be vital in another area: understanding how the integration of the two firms will be carried out after the deal is closed and ensuring it is done swiftly and efficiently.

Modelling and business models Another natural area for accountants is in formulating the business plan. Although marketing, manufacturing and distribution may not be the accountant's specialty, setting management compensation or determining capital structure are.

Dagua found its accountant's high value area was financial forecasting. “His expertise proved essential,” Bélanger says. “Sure, management knew what the money inflows and out-

flows were in a few areas, but those represent maybe 10 out of 60 lines in a spreadsheet. We were at a loss concerning the way to account for cash flows around real estate, purchases, diverse depreciations and sales tax inputs. Our accountant knew.”

Underlying the business plan, the accountant finds the business model and the key question it seeks to answer: what are the basic ways the company generates revenue and profit? “This is a huge area,” Robinson says. “There are so many changes going on out there, the company must question and find ways to capture opportunities.” Obvious questions include: what parts of the firm should be outsourced? Should a company relinquish its manufacturing role to become only a design office or a distributor? What about online commerce? How do you balance marketing between brick and mortar stores and online stores? Do you invest in publicity online or in traditional media?

Four emerging trends

Specialists have identified four areas at the periphery of the accountant's traditional role, where his or her qualifications allow him or her to outperform any other professional.

Where do costs hide? While a company doesn't always have control over prices, which depend on market forces, it can control its costs. That's why, in times of economic hardship, many companies look inward to try to improve their cost structure. Unfortunately, “too many SMEs don't even know what their costs are,” says Lavigne. “Their cost accounting is nonexistent.”

“Because companies have no idea where their real costs lie, often profits stay flat even when sales rise,” says Christian Babbini, vice-president at Decimal, in Longueuil, Que., which designs cost-accounting software for SMEs. “This happens because they don't know which clients and which products are most profitable and they don't invest their efforts where they can be most productive.” According to Lavigne, cost accounting is where accountants can make a real difference, but it's also an area they neglect to promote to their clients.

Taming the risk devils Managing the risks a company confronts is something people do intuitively, but Nadeau says it should be structured and carried out systematically. Drew Byers, president of Edmonton-based Byers Butler Insurance Ltd., describes the issue in stark terms: “If I'm hit by a bus, what happens to the company, to clients, to partners? Such questions helped us put things in clear focus and forced us to design contingency plans.”

Nadeau's specialty is to identify risks that lie at four levels (strategy, operations, finance and legal conformity) and to mitigate them. He gives the example of a company that wants to expand into the US, something many Canadian firms have undertaken in the past few decades with costly outcomes that could have been avoided by evaluating risks more adequately.

“At the operational level, we will look at the dependence the company has on certain machinery or on a supplier or distributor,” Nadeau says. “We look at the impact currency exchange levels can have. There are methods to evaluate these risks, establish their level of probability, number them in dollars and find ways to mitigate them.” Who but an accountant can do this better?

All in the family Succession in family businesses is a major issue and will be for the next decade. “With the boomer generation, we will see the biggest transfer of wealth ever; between \$10 billion and \$15 billion,” says Barns. The challenge is heightened by the fact that, since boomers had children later in life, the next generation is not yet of an age to take the mantle.

Accountants are uniquely qualified to address many issues in family successions, says Robinson, whose firm specializes in such succession issues as estate freezes, valuing the business and transferring shares. But the real value accountants can bring is in the soft skills of dealing with people, emotions and egos. “It’s about dealing with the elephant at the table,” says Barns. For example, son John is an alcoholic and making him CEO would compromise the company. Those kinds of issues ruin family businesses and accountants have to address them, explains Robinson.

The 100-year-old company Byers heads has had plenty of practice in transferring the reins from one generation to the next. It is now in the fourth transfer as the presidency moves to Byers’ son Scott. “Because we’ve done it before doesn’t mean we

can’t go wrong,” he says. The key, he insists, is communication and ensuring everyone knows where the company wants to go.

Communication is not necessarily the primary competence of accountants, but those who take it up can make a significant difference for clients facing a succession challenge.

May the network be with you An accountant’s greatest asset might be his or her network. Large firms have an advantage in this respect, but smaller firms can compete by partnering with other firms to create high-value informal networks.

Entrepreneurs typically work in a multitasking mode to find information, financial contacts and employees. “And for this they need to have access to networks,” says Ted Mallett, CFIB chief economist. “An accountant is a key resource for this.”

And networks bring a number of things to the table. A company looking for capital can use an accountant’s network to find financial angels, private equity firms or strategic partners. Ernst & Young partner Colleen McMorro suggests that a company looking for a growth path can ask what similar firms are doing and how it can leverage the experience and perspective accountants bring. “Such an added value can be huge,” she says.

Adding all the services, the full value an accountant can bring to SMEs is even greater. In fact, the whole is so colossal, you may wonder how accountants remain so unassuming.

Yan Barcelo is a Montreal-area freelance writer



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Fairfax Financial Holdings Ltd. and Brick founder William Comrie buying up the bulk of the units. The company lined up another \$65 million through a new asset-based credit facility. As Yost put it, “The recapitalization transaction provides the necessary financial flexibility and capital resources to manage the business in the current economic climate.”

The Brick was lucky to survive. BDO Dunwoody financial recovery services partner Susan Taves, based in Kitchener, Ont., has spent the past year watching many small and medium enterprises (SMEs) endure their variations of The Brick’s story, or worse, as is the case in southern Ontario’s auto-parts sector, where venerable companies are so hobbled that even a stem-to-stern restructuring won’t help. “The most dramatic issue is the reduction in sales volume,” says Taves, a CA who is also a chartered insolvency and restructuring practitioner (CIRP). “Within a year, if a company was doing \$12 million, now we’re talking half, maybe. With such a dramatic decrease, it’s just so significant.”

The problems, of course, aren’t limited to Ontario’s manufacturing and retail sectors. Bruce Alger, president of Alberta-based Alger & Associates Inc., a corporate and personal financial restructuring company, says he’s seeing clients in the oil and gas sector, small-scale retail, and tourist-driven businesses in the mountains.

On the bright side, there is some emerging evidence to suggest that small businesses are more likely to survive because they had started the process of containing costs before the mass layoffs began in earnest last year.

Still, the existential question facing business owners is whether there are restructuring strategies — either an informal or formal insolvency process — that can bring their recession-hobbled companies through the hurricane. Much depends on the sector in question, cautions RSM Richter senior partner and CA-CIRP Peter Farkas. “If there’s no viability, you’re going to wind it up in the most efficient way. If there is viability,” he adds, “at a minimum you’re looking at a balance-sheet fix.”

In this climate, surgery may also be needed. Some may be able to pull it off on an outpatient basis while others are looking at a major operation. Whatever is required, restructuring experts say it is critical not to wait until things go crazy before seeking advice. “Time is of the essence,” says bankruptcy trustee Stéphane Lachance, a CA-CIRP and partner at Demers Beaulne in Montreal. “They need to act promptly.”

When chartered accountants with CIRP designations are retained by companies with mounting financial strains, they quickly check the corporate vitals for signs of distress. Loss of top-line income may be the most obvious symptom, but in this climate, there are many other warning signals: difficulty meeting short-term payables; stringing along suppliers; eroding liquidity ratios; exhausted bank lines; and a general decline in working capital. “They’ve gotten to the point where there isn’t any more credit available to them,” says CA-CIRP Ira Smith, a Toronto-based trustee in bankruptcy. “They’re hitting the wall.”

In the past half-year, however, many firms have been felled by an economic domino effect as the global credit crunch decimated consumer spending and the effects were felt all the way down the commercial food chain. The final straw may be the loss of shelf

space at Wal-Mart or some other big-box store. “Sometimes the signs are very rapid,” says Lachance. “You may lose your biggest customer because [it] may have filed for creditor protection under the [Companies’ Creditors Arrangement Act].”

Jervis Rodrigues, a Vancouver-based CA-CIRP and partner in charge of Deloitte’s financial advisory practice, also notes that many companies have also found themselves in a vice, with reduced orders from customers and higher input costs due to rising prices for some commodities, such as steel. “They’re getting squeezed from both ends,” he says. “There’s less and less margin available for them to make a viable business going forward.”

Companies facing such pressures need to take a couple key steps. The first is to be proactive and frank about sharing the bad news with their bankers. “The universal rule is, never surprise your banker,” says Rebecca Reuber, professor of strategic management at the University of Toronto’s Rotman School of Management. Tell them about relationships with key customers and suppliers, and provide accurate financial information. “Be in touch with your banker every month.”

The other important step, says Taves, is to quickly snuff out signs of crisis by clearly communicating with employees and suppliers. She cites the common example of the accounts payable staff fielding frantic calls from angry suppliers who haven’t been paid for months. Instead, senior management should hustle to fax out a general letter to all suppliers acknowledging the cash-flow problem and assuring them it’s being addressed. “Everyone is getting the same message,” says Taves. “Now your accounts payable staff isn’t on the phone the whole day talking to screaming people.”

Similar steps should be taken with employees and management as a way of tamping down the rumour mill and preserving productivity. “It relieves pressure on CEOs so they can get their team to focus on what they need to do,” Taves says. And thus the search for cash begins.

Restructuring tips

- Don’t wait until you run out of cash and credit to see a restructuring specialist.
- Identify key employees the company can’t survive without; they may include controllers, shop foremen and key sales people.
- Talk frankly to your key customers and find ways to make sure they don’t leave you.
- Resist the temptation to use your tax remittances as short-term emergency cash. CRA has more rights than other creditors.
- Ensure your lenders have timely and credible financial information.
- If you are heading for a proposal, calculate your anticipated burn rate and then build a war chest with enough cash to cover two months of operating costs.
- Once you have filed, don’t dither. The courts will grant extensions, but not indefinitely.

— JL



The moral of Smith's story is that a formal restructuring process, when managed with strategic savvy, may yield surprising results, not the least of which is that the distressed company lives to see another day.

The insolvency practitioner's task is not merely palliative

Restructuring experts tell owner-operators to go through the balance sheet with a fine-tooth comb, looking for opportunities to monetize assets or reduce costs. "Every business — small, medium or large — should be looking at its entire [selling, general and administrative] costs," says Rodrigues. The obvious steps include laying off surplus employees, paring back benefits, freezing salaries, and doing away with frills — for example, first-class airfare and hotels for business travel, and client entertaining.

While the need to cut is great and immediate, businesses need to ensure they don't sustain self-inflicted wounds. Before cutting staff, senior management must identify key employees who should be retained. And they should cut marketing expenses judiciously. If a firm suddenly stops attending important trade shows, competitors, suppliers and customers may read that absence as evidence of critical illness.

PricewaterhouseCoopers advisory services partner Greg Prince recommends that his clients look for other sources of ready cash — uncollected receivables, stale inventory that can be liquidated in nontraditional retail or wholesale channels, and unredeemed scientific research and experimental development tax credits. Make sure tax filings are up to date to avoid late charges, and ensure that any foreign currency accounts are hedged. Other options include renegotiating prepaid orders and asking vendors to extend payment periods. Lastly, many companies have real estate holdings that can be sold and leased back, even if at a loss. "The key message," says Prince, "is that you can walk down the left side of the balance sheet and see what you've got." Adds Rodrigues: "In a recession, cash is king."

Given the economic climate, however, such steps may not be sufficient to address short- and medium-term cash needs. And many owner-operators will find themselves thinking about how to squeeze additional credit from lenders whose antennae are up. At this point, though, it's no longer just about maintaining an open relationship with the bankers. "They will ask entrepreneurs to put up assets that haven't been pledged to prove they believe in their own recovery plan," says Smith. "Those are gut-wrenching decisions." He urges entrepreneurs,

who tend to be emotionally invested in their companies, to be as clinical as possible: "If the business won't survive, don't pledge personal assets. Rather, use those as the starting point for the rest of your life."

Last year, Toronto fashion designer Linda Lundström hired Smith to deal with what looked to be an escalating crisis. Lundström, who operated a manufacturing facility and a small chain of retail boutiques, had hit a wall and Smith recommended she file a proposal for creditor protection under the Bankruptcy and Insolvency Act (BIA). After analyzing the situation, Smith's firm partnered with a liquidator who was prepared to finance enough additional production to hold a bankruptcy sale at Lundström's retail outlets. Having moved to bring in some cash from the business, he put together a plan for the secured creditors that involved a small shortfall the principals would agree to cover. "The bank," says Smith, "bought into the plan."

Lundström then moved quickly to file the formal restructuring proposal and commence the liquidation, all while keeping the company's retail outlets open to the public. With the stores operating as a separate legal entity, Smith bankrupted the retail division in order to run the liquidation sale. But due to the publicity generated by the advertising for the sale, a pair of investors approached Lundström about acquiring the manufacturing operation. "The return," he says, "was even more than they'd expected." Lundström today is making and selling her brand across Canada and the US in partnership with Eleventh Floor Apparel Ltd., the Canadian investor who stepped up to buy the insolvent firm.

The moral of Smith's story is that a formal restructuring process, when managed with some strategic savvy, may yield surprising results, not the least of which is that the distressed company lives to see another day. It's a point Taves stresses with her clients in order to counter the perception that the insolvency practitioner's task is essentially palliative. "We are not just the undertakers of the business world," she says. "Coming to see an insolvency and restructuring professional is not the end of the world."

Formal insolvency is not a cheap process; costs for an SME can run from \$25,000 into the hundreds of thousands

Trustees also point out that the current climate has created a very different dynamic between distressed firms and their creditors. There's a greater appetite for prepackaged bankruptcies and informal proposals to creditors made outside the legal process.

What's more, trustees say they're seeing some unprecedented attitudinal changes on the part of banks, whose loan officials recognize that aggressively petitioning troubled companies into receivership may make sense on paper but can serve to aggravate the social woes of the economy. "I think there are increasingly large amounts of patience," says Alger, a CA who is also on the national board of the Canadian Association of Insolvency and Restructuring Professionals. Banks, he says, can see for themselves that a growing number of troubled firms aren't badly managed but rather victims of large-scale economic decline.

"I've never before seen banks considering the social benefits of allowing a company to survive," adds Joe Albert, senior vice-president at msi Spergel inc., an Ontario company specializing in commercial and consumer insolvency and restructuring. "Banks are very reluctant to enforce their security unless it involves a game plan that the company's shareholders consent to."

What's also true is that secured creditors know they are not going to recoup much from selling off a company's assets in the current climate. "Lenders realize that asset values on the liquidation market are very, very low," says Prince. "There is a desire to see if they can ride it out. But they don't want to be worse off."

Despite such expressions of forbearance, and the implications for pulling off a restructuring plan, formal insolvency is not a cheap process — costs for an SME can run from \$25,000 into the hundreds of thousands, depending on the complexity of the organization, so companies considering this step need to find that kind of cash at a time when their reserves are severely depleted.

What's more, the mere act of filing a notice of intent to apply for creditor protection can be ammunition for a firm's competitors, who will spread the word among your customers that the firm's gone bust. "You'll lose some of your clients," says Lachance.

To mitigate the problem of costs and loss of confidence, Alger says he has been doing a lot of informal restructurings lately. In such scenarios, the trustee and the company approach suppliers and secured creditors with a plan — for example, proposing payment at 70¢ or 80¢ on the dollar. "They are trading on their goodwill and long-term relationships," he says. "If you have a long-term track record, you can frequently do things that may not seem possible."

Farkas adds that it is also possible to approach creditors such as landlords and propose rejigging payment terms, with an eye to temporarily reducing the current burn rate but holding to the overall lease commitments by offering to back-end payments: "I'm not saying I'll never pay you, just not now."

The prepackaged or "orderly" bankruptcy is a variation on the theme, with the parties and prospective stakeholders hav-

ing negotiated the deal before going to court. Avoiding a free-fall bankruptcy is especially important for service firms with sensitive reputations, such as courier companies or private schools, observes Farkas. "It's doubly imperative to do a prepack in a service business, otherwise the goodwill disappears instantly."

Yet the reality is that some restructurings require insolvent firms to legally extricate themselves from long-term supplier contracts and real estate or equipment leases. But with vendors and landlords also feeling the economic heat, they may be unwilling to renegotiate.

Albert observes that expected changes in the BIA will facilitate this process. Under the existing law, companies can terminate property leases, with the landlord becoming a creditor. "With the new act, you'll be able to get out of any contract that impairs the company's viability," he says, noting one qualifier. "For political reasons, the government stopped short of allowing companies to terminate a collective agreement." As a compromise, the amendments will allow bankruptcy courts to order the parties to re-open bargaining.

Last, but not least, it is crucial for firms that are in the midst of a formal restructuring to reconsider the ownership structure. Farkas says he often encounters a troubled SME with several shareholders, only one of whom — probably the founder — still believes in the business. Using net worth that is not tied up in the company, "the founder can become part of the new company that emerges from the restructuring." That transition may also entail this shareholder buying out his or her partners. "You put it through the washing machine so that this owner ends up with 100% of the equity. That can be a pretty effective restructuring regime."

Though he's in the business of tallying up numbers, Albert says the owner-operator's attitude may be the pivot upon which a restructuring turns. "In my opinion, one of the biggest keys to success is having a passion for the business. It's such a strong indicator of success."

Picking up on that point, Reuber points out that hard times provide determined SMEs with a mandate to focus intensively on their customers and to make sure they don't bolt or vanish in times of stress. "Now," she says, "is the time to surprise them favourably." It's also an opportunity for companies to take a hard look at their HR practices and get rid of ineffective employees. And, given the tight job markets, firms that are hiring have the pick of the crop — in short, the downturn opens up a window for firms to equip themselves with the best employees they can recruit. "In terms of business processes, I do firmly believe that the businesses that survive this recession will emerge so much stronger and focused, internally consistent and innovative."

John Lorinc is a Toronto-based writer



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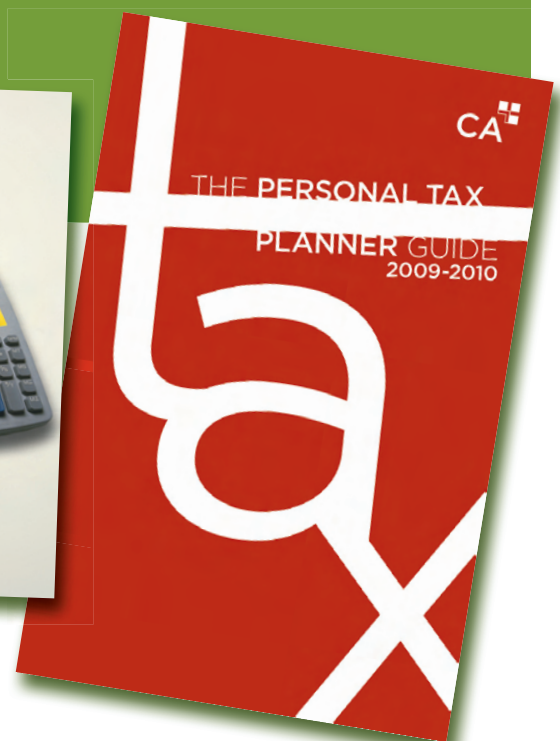
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Just a few months to go

IFRS transition is just around the corner, and here are a few practical steps toward the implementation of IFRS 1

IFRS 1, *First-time Adoption of International Financial Reporting Standards*, is the most important standard for all first-time adopters of IFRS, and the opening balance sheet at the transition date hinges on the successful implementation of this rules-based standard. The many rules of IFRS 1 may seem like a paradox when read alongside the predominantly principles-based IFRS standards. For preparers of financial statements, the good news is these rules will help make the transition smoother. IFRS requires management to prepare its opening balance sheet at the date of transition — for example, January 1, 2010 — for calendar year-end publicly accountable Canadian companies. The transition date is the start of the earliest period that a company must present full comparative information under IFRS in its first IFRS financial statements.

IFRS must be adopted retroactively, also known as retrospectively, as if IFRS has always existed. The benefits of IFRS 1 are that it provides a list of possible exemptions to the retrospective application of IFRS that companies can elect. It also provides a list of four mandatory exceptions, which are required on transition to IFRS. (These exceptions are not discussed here, the focus being on the optional elections.) The standard also provides guidance about how to prepare an opening balance sheet, which then becomes the starting point for compliance with IFRS. Given that there are only four months left until the transition date for calendar year-end companies, those that are just beginning their IFRS 1 considerations and those that have already been evaluating the IFRS 1 standard may benefit from the hindsight and experience of those, such as Ontario Power Generation Inc. (OPG), that are advanced in the evaluation of IFRS 1.

OPG commenced its IFRS conversion project during

IFRS 1 exemptions

- Business combinations
- Share-based payments
- Insurance contracts
- Fair value as deemed cost
- Leases
- Employee benefits
- Cumulative translation differences
- Investments in subsidiaries, associates and joint ventures
- Assets and liabilities of subsidiaries, associates and joint ventures
- Compound financial instruments
- Designation of previously recognized financial instruments
- Fair-value measurement of financial assets and financial liabilities
- Decommissioning, liabilities included in the cost of property, plant and equipment
- Financial assets or intangible assets accounted for under IFRIC
- Service concession arrangements
- Borrowing costs

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2007. By the end of 2007, the power generator had completed the diagnostic phase, which involved a high-level review of the major differences between current Canadian GAAP and IFRS. OPG determined that the differences with the highest potential to impact OPG's accounting included rate regulated accounting, accounting for fixed assets, asset retirement obligation accounting, as well as the initial adoption of IFRS under the provision of IFRS 1. The preliminary review of IFRS 1 began in January 2008, and the detailed review began in June 2008. Starting the detailed IFRS 1 review then was appropriate for OPG, as it had already begun the evaluation of all other accounting areas, thus enabling it to include the impact from these areas in the detailed IFRS 1 review. It also wanted enough time to make the appropriate election choices. Looking at IFRS 1 early gave OPG the opportunity to consider many factors in its decision-making process, given the decisions will have lasting effects, as the choices made provide the starting point for future financial reporting under IFRS.

Canadian firms should devote sufficient time and resources to IFRS 1 immediately. If IFRS 1 decisions aren't made by January 2010, it will be difficult to re-create the financial information under IFRS after the transition date. The full period of 2010 is a dual reporting year for calendar year-end companies, as they are required to report Canadian GAAP financial information while tracking IFRS financial information in their systems/processes. The latter set of financial statements can't be done without the transition balance sheet completed as a starting point. Don't miss opportunities for maximizing the full use of the IFRS 1 elections and the associated accounting policy decisions most advantageous for your firm.

Practical steps to implement IFRS 1

- *Begin immediately, if you haven't already. Review progress regularly, especially when reviewing IFRS 1 in conjunction with other IFRS standards*

OPG began a preliminary evaluation of IFRS 1 during the evaluation of specific accounting areas. For instance, one of the first areas of focus evaluated in January 2008 was accounting for fixed assets, and so IFRS 1 considerations relating to fixed assets were evaluated at that time. When it came time to work on the IFRS 1 workstream in detail in June 2008, OPG understood which elections were relevant, so it could proceed on a detailed evaluation of the standard.

- *Prioritize: determine which elections to focus on and evaluate in detail. Identify marginal and/or irrelevant elections*

The first step in OPG's detailed review of IFRS 1 was to list all the exemptions available. Then, one by one, it identified those that were not applicable. From the remaining exemptions, it identified those that could be significant given the preliminary analysis when it evaluated IFRS 1 in conjunction with other IFRS standards, and those significant elections were the ones it focused its efforts on. The March 2009 edition of IFRS 1 lists 15 exemptions to choose from. These exemptions to retrospective application apply to specific sections of specific standards, not

IFRS standards in their entirety. It is important to be familiar with the many paragraphs devoted to each exemption (see table on page 32) in IFRS 1 to fully understand the specific section that is exempted.

- *Devote specialized resources to the working team*

Once you determine which elections are applicable to your company, determine the resources with specialized knowledge of the specific accounting area that you need for your team. It is good to have a single resource responsible for leading the analysis of IFRS 1, and your team may be comprised of financial instruments specialists, fixed assets specialists and pension experts.

- *Consider the interrelation between the IFRS 1 elections. Don't assume they are mutually exclusive just because each election makes reference to a different IFRS standard*

A main reason why OPG spent a significant amount of time on IFRS 1 was the way certain elections impacted other elections. There is a pecking order in approaching how the impact of all the elections can best be analyzed and quantified. For instance, if the business combinations exemption is elected, then any

If IFRS 1 decisions are not made by January 2010, it will be difficult to re-create the financial information under IFRS after the transition date

retrospective application of the IFRS standards relating to the acquired business would only need to be restated under IFRS retrospectively to the acquisition date. This is a significant impact on any of the other exemptions. For example, if you acquired a business with a defined benefit plan then decide not to elect the employee benefits exemption, the interrelation between these two elections will drive a transition adjustment that could be quite different from the transition adjustment resulting from electing the employee benefits exemption.

IFRS 1 allows a first-time adopter to elect to recognize all cumulative unamortized actuarial gains and losses at the date of transition to IFRS, even if it uses the corridor approach for later actuarial gains and losses. If your company chooses not to elect this exemption, then you must evaluate all your pension assets and obligations retrospectively for the IFRS and Canadian GAAP differences and restate these pension amounts under IFRS. Restating amounts may require actuarial valuations and information that may not be readily available from your actuary or custodian. Although you would only need to retrospectively go back to the acquisition date of that particular business and determining these accounting differences in principle may be easy, quantifying them may not be.

Another example of an interrelation between IFRS 1 elections is the option to elect the valuation of certain fixed assets at fair value on the transition date to be deemed as cost and the option related to changes in the decommissioning of liabilities included in the cost of property, plant and equipment. The latter

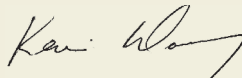
NOTICE OF ANNUAL MEETING

Toronto, Ontario, September 23, 2009

The one hundred and seventh Annual Meeting of the members of The Canadian Institute of Chartered Accountants will be held in the Carmichael/Jackson Rooms, Hilton Toronto, 145 Richmond Street West, Toronto, Ontario, on Wednesday, September 23, 2009, at 09:00 hours (Local Time) for the reception of the reports of the Chair and the Board of Directors; the reception of the financial statements of the Institute for the fiscal year ended March 31, 2009, together with the auditor's report thereon; the appointment of an auditor for the current fiscal year; and for the transaction of such other business as may properly come before the meeting.

Sub-section 20(3) of the by-laws permits members to be represented by proxy at any annual or special meeting of members of the Institute and provides that no proxy shall be exercised by a person who is not a member of the Institute. If any member wishes to be represented by proxy, any proper form may be used. As a convenience to members, however, a form of proxy has been posted on CICA's website. Proxies for use at the meeting should be returned promptly to the attention of Mr. Walter Palmer, Fasken Martineau DuMoulin LLP, 66 Wellington Street West, Suite 4200, Toronto Dominion Bank Tower, Box 20 Toronto-Dominion Centre, Toronto, Ontario M5K 1N6.

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exemption refers to IFRIC 1, and so this may appear unrelated to the former exemption; however, both elections impact property, plant and equipment. How each election interrelates will drive how the opening balance sheet numbers are derived, so these elections must be considered collectively when deciding whether or not to apply them.

• *Involve the right people in the decision-making of the elections*

Successful implementation of IFRS 1 involves considerations outside the technical accounting details. When OPG established a formal project governance structure in 2007, the inclusion of a technical review committee was important. In addition, the steering committee of senior management from finance, and representatives from all business units and IT proved very useful in some decisions and considerations involved in making the IFRS 1 choices. Also keep your auditors informed of your key decisions as you are contemplating them, especially if you decide not to take an election. In addition, regularly update your audit/risk committee of the board of directors for IFRS, and in particular, IFRS 1 implications on the opening balance sheet.

• *Leverage external resources*

IFRS 1 is not new. More than 100 countries have already adopted IFRS, and many of the companies in these countries were eligible to make choices under IFRS 1. Therefore, there are many

financial statements available that illustrate those companies' IFRS 1 note disclosures. The IFRS 1 note disclosures OPG looked at ranged from three pages in length up to 24 pages, so some navigation may be necessary. To complement research of IFRS 1 disclosures, you may wish to retain the services of an external IFRS consultant with European IFRS conversion experience and knowledge of the supporting reasons behind certain IFRS 1 decisions. In addition, direct contact with European companies can provide first-hand information of their IFRS 1 decisions. If so, your discussions may exceed the benefits of simply attending IFRS 1 training sessions. One word of caution with leveraging the European experience: it can take time to coordinate and don't always expect to receive thorough documentation in support of positions taken. Also, what was significant for European companies differs from what is significant for Canadian companies, financial instruments being one of the main ones. Canadian companies have already adopted much of the IFRS financial instruments standards given the change in Canadian standards to be more aligned with IFRS ahead of transition, and so Canadian companies only need to focus on the differences that remain relating to financial instruments.

Canadian industry groups are another resource available to most companies. They provide opportunities to discuss best practices, implementation difficulties and emerging issues amongst members, especially when members get together regularly and



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compare notes. Most industries have that outlet, but not all members make use of it. A company's external auditor can also provide assistance by connecting with European counterparts for practical guidance. Such resources and connections helped OPG in its overall transition to IFRS, not just in implementing IFRS 1. As a result, it has become an automatic response at OPG over the past 18 months to ask, So what did they do in Europe? What are others doing in Canada?

• *Communicate with stakeholders*

Communication about preliminary opening balance sheet numbers and the effects of IFRS 1 is necessary to determine if there is anything else that needs to be considered. Don't forget to consider tax impacts of the opening balance sheet. Business planning will need to know of opening balance sheet impacts in order to plan future income statement changes, especially for five- or 10-year business plans. If your company is regulated, such as a bank or utility, the regulator may establish reporting requirements that may result in additional record-keeping. It is essential to work with the regulator to minimize these additional requirements. Communication with external stakeholders should include your bank. If you need to provide awareness training to stakeholders to put your IFRS 1 discussions into context, an introduction course is available. The CICA website offers a three-hour computer-based training session, which gives a high-level overview of IFRS and

spends approximately five minutes on IFRS 1, providing good context as to how IFRS 1 fits with the rest of the IFRS standards.

• *Prepare or update the opening balance sheet on the transition date*
The conversion to IFRS is a significant project, and it may be easy to get lost in the details or be tempted to postpone its implementation. As there are many aspects of IFRS 1 to be considered, waiting to implement this standard may be a mistake. Yes, there are potential changes in IFRS on the horizon that could impact transition adjustments, and yes, a process will be needed to track and implement these, but they should not be cause for delaying the conversion effort. If you devote the right amount of time and resources to this workstream, you may be in a good position on the transition date. You may only have to update the opening balance sheet and finalize the related IFRS 1 note disclosures because all your processes have been put into place to capture adjustments for IFRS and IFRS 1. The opening balance sheet and related disclosures will be one of the factors that will help you gauge your company's success in the implementation of IFRS 1.

Joanne Barradas, CA, is acting director of accounting and former manager of IFRS conversion at OPG, an Ontario-based electricity generation company

Technical editor: Ron Salole, vice-president, Standards, CICA

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Obama's proposals

A few of the US tax changes could be relevant to Canadian subs of US multinationals and US subs of Canadian firms



On May 4, 2009, US President Obama announced proposals that would make expansive, fundamental changes to the US international tax system and raise approximately US\$210 billion over 10 years.

These proposals would curtail the ability to use the check-the-box (CTB) regulations in structuring foreign operations; reform deferral of foreign income by restricting expense deductions; restrict the ability to use foreign tax credits (FTC) for companies with deferred foreign income; tackle abuse of tax havens by individuals; reform certain rules applicable to foreign intermediaries that are not qualified intermediaries; hire 800 new IRS staff to increase international tax enforcement; and make the research and experimentation credit permanent.

On May 11, 2009, the administration detailed its pre-

viously disclosed tax proposals included in the 2010 budget, along with several new proposals, in the Treasury Green Book. A few of the changes that may be relevant to Canadian subsidiaries of US multinationals and Canadian multinationals with US subsidiaries or activities include proposals to repeal the 80/20 company rules, which have been used by some companies to minimize US withholding tax; codify the economic substance doctrine and increase penalties for transactions lacking economic substance; limit earnings stripping by entities expatriated (US parent corporations that are essentially replaced by foreign parent corporations) after July 10, 1989; limit income shifting through intangible property transfers; prevent earnings repatriation in certain crossborder reorganizations; and further reform the FTC rules by preventing splitting of foreign income and foreign taxes.

A number of these proposals together could impose a

GARY CLEMENT

de facto tax increase on certain US businesses. In contrast, many countries have recently been reducing their corporate tax rates. Among countries that host a sizable number of large multinationals, the US now stands alone in having both a system that taxes worldwide income as well as a corporate tax rate above 30%.

Although most of the proposals have been announced with an effective date of January 1, 2011, it is possible that US Congress may consider using some of these proposals as revenue offsets for other legislative priorities this year. (Congress generally adheres to a pay-as-you-go budget rule requiring legislation that increases mandatory spending to be fully paid for by legislation that increases revenue.)

What is CTB? The CTB regulations generally allow eligible business entities to elect how they will be classified for US federal tax purposes.

CTB proposal The administration proposes to restrict the application of the CTB rules in certain cases where foreign eligible entities elect disregarded entity treatment. Under the proposal, a wholly owned foreign eligible entity would generally no longer be permitted to elect disregarded entity treatment if it is not organized under the same foreign country laws as its sole owner.

Generally, a foreign eligible entity that is organized in a different country than its single owner would be treated as a corporation. For example, a Barbados LLP, or other non-Canadian foreign eligible entity, wholly owned by a Canadian corporation, would appear to be forced into corporate treatment (i.e., denied disregarded entity treatment).

The rule appears to be intended to prevent the use of CTB to improperly avoid the Subpart F antiferral rules. For example, second-tier foreign subsidiaries (currently disregarded entities) of a US multinational would be treated as corporations and payments between such entities could be currently included in the multinational's income.

An exception applies where the regarded owner is someone in the US. Generally, a first-tier foreign eligible entity wholly owned by a US person may elect treatment as a disregarded entity. A first-tier foreign eligible entity wholly owned by a US person would be forced into corporate treatment only where US tax avoidance is present. Thus, a Canadian unlimited liability company wholly owned by a US corporation would be permitted to elect disregarded entity treatment, barring US tax avoidance. US tax avoidance is not defined in this proposal and so the scope of the exception is not yet known.

This proposal addresses neither foreign eligible entities with multiple owners nor US eligible entities. Based on the limited information available, it appears that US and foreign eligible partnerships would be permitted to elect corporate treatment (so-called reverse hybrid) and US limited liability companies may elect corporate or pass-through treatment.

This proposal does not contain a grandfathering rule. The tax treatment of the conversion of a foreign disregarded entity into a

corporation would be consistent with general US tax rules relating to the incorporation of a foreign entity. The provision is estimated to raise more revenue than any other international tax proposal.

What is deferral? US companies that generate active business income abroad pay tax on the foreign earnings in the local country where the income is earned. When the company repatriates the income back to the US in the form of dividends, the foreign income is then taxable in the US, subject to an FTC. The US taxes the worldwide income of US companies, but the US tax on active foreign business income of foreign subsidiaries of US companies is deferred until that income is paid to the US companies.

Deferral proposal Similar to the 2007 Rangel Bill, the administration proposes to reform deferral by requiring US corporations that defer income through controlled foreign corporations to defer deductions (and recognition of foreign taxes) associated with the income. The US corporation's deduction would be deferred for expenses allocated and apportioned to foreign source income (under current regulations), to the extent such foreign source income related to such expenses is not subject to current US

In sum, it is imperative that Canadian and US multinationals evaluate how the proposed reforms would affect their companies as soon as possible

tax. The deferred expenses for a tax year would be carried forward to subsequent years and added to the US persons' foreign source expenses for such year, before applying the deferral proposal rules in the subsequent year. Thus, deferred deductions (and foreign taxes) may be recognized when the deferred income is repatriated to the US.

This measure could increase the global tax rate of many US companies that invest in Canada and other foreign jurisdictions. This proposal is similar in some respects to the controversial proposal in the 2007 Canadian federal budget to restrict the deductibility of borrowing costs for funds used by Canadian firms to invest in foreign affiliates. Widespread concerns about the anticompetitive impact of the Canadian proposal led to its narrowing in the form of the more targeted anti-tax haven measure in Section 18.2 of the Income Tax Act and to the repeal of Section 18.2 prior to its proposed effective date of January 1, 2011.

FTCs The current FTC rules were intended to alleviate double taxation on foreign income earned by US taxpayers who are subject to worldwide taxation. The person considered to have paid a foreign tax for FTC purposes is the person on whom foreign law imposes legal liability for the tax (the so-called technical taxpayer rule). Current rules can allow excess foreign tax on high-taxed foreign income to be used to offset US tax on low-taxed foreign income (crosscrediting). In addition, the technical taxpayer rules can allow a person to take an FTC even in a case where the person is not currently subject to US tax on the underlying income.

FTC proposals The Green Book contains two proposals. First, the FTC allowed with respect to a dividend paid by a foreign subsidiary (the deemed paid FTC) would be calculated on a consolidated basis, by determining the aggregate foreign taxes and earnings and profits of all of the foreign subsidiaries for which the US corporation may claim a deemed paid FTC. Second, the proposal would adopt a matching rule to ensure that the party claiming FTCs is the party who actually earns the income on which the tax is imposed. These proposals would likely restrict crosscrediting and no longer allow FTCs for taxes paid on income not subject to US tax. Accordingly, US corporations would lose their incentive to repatriate income from high-tax jurisdictions such as Canada, in an effort to maximize their FTCs.

What is an 80/20 company? Current law provides that interest and dividends paid by US companies are generally US source. An exception to that rule exists for 80/20 companies. A dividend from a US corporation that is an 80/20 company would be exempt from US dividend withholding tax. An 80/20 company is generally a US company that derives at least 80% of its gross income during a testing period (generally the three years prior to the payment) from active foreign businesses.

Proposal to repeal 80/20 rules The administration proposes to repeal these rules in their entirety. This may result in arguably unfair treatment for certain taxpayers. For example, a Canadian multinational that owns a US holding company that owns lower-tier Canadian or other foreign operating subsidiaries (sandwich structure) may currently be exempt from US dividend and interest withholding tax on such payments made by the US subsidiary to the Canadian parent. Under this proposal, the sandwich structure would become subject to an extra layer of US withholding tax on such payments since the payments would be treated as US source income. Taxpayers affected by this and other proposals should consider whether to move their

foreign subsidiaries out from under the US prior to the effective date of this measure.

The combined changes the administration has proposed would affect the tax position of many US companies in a manner that is similar to repeal of deferral and imposition of immediate US tax on the active foreign business income of foreign subsidiaries, including Canadian subsidiaries. The proposals would have far-reaching implications. Businesses may be forced to rethink supply chains, countries of operation and other fundamental operating questions and can expect an increased tax burden on both their foreign and domestic operations.

The CTB proposal would result in the conversion of existing checked entities into corporations, resulting in deemed restructuring transactions, with associated (potentially adverse) US tax consequences. Affected entities should examine such consequences and consider whether alternative restructuring steps should be undertaken to mitigate potential adverse tax consequences that could arise from the deemed restructuring transactions.

In sum, it is imperative that US and Canadian multinationals evaluate how the proposed reforms would affect their companies as soon as possible, as legislation such as these proposals could move quickly out of the budget process and be included in other legislation being considered by Congress. Companies should consider modelling the potential impact of the proposals on their business. Modelling findings may assist companies in preparing for the proposed reforms and assessing the value and extent to which pre-effective date planning and restructuring is warranted.

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Changes ahead

To ensure a smooth transition to new auditing standards, auditors and their clients will need training and information

As of the end of 2009, generally accepted auditing standards (GAAS) will be called Canadian auditing standards (CAS). In June 2006, the Auditing and Assurance Standards Board decided to adopt the international standards on auditing (ISA) as Canadian GAAS for financial statement audits. This transition will have a direct impact on all external auditors in Canada.

Even though auditors apply the best auditing practices, CAS will entail significant changes to current audit programs and to auditor behaviour. To ensure a smooth transition, auditors and their clients will require training, information and professional development.

Effective date for the initial adoption of CAS

Audits of financial statements for years ending on or after

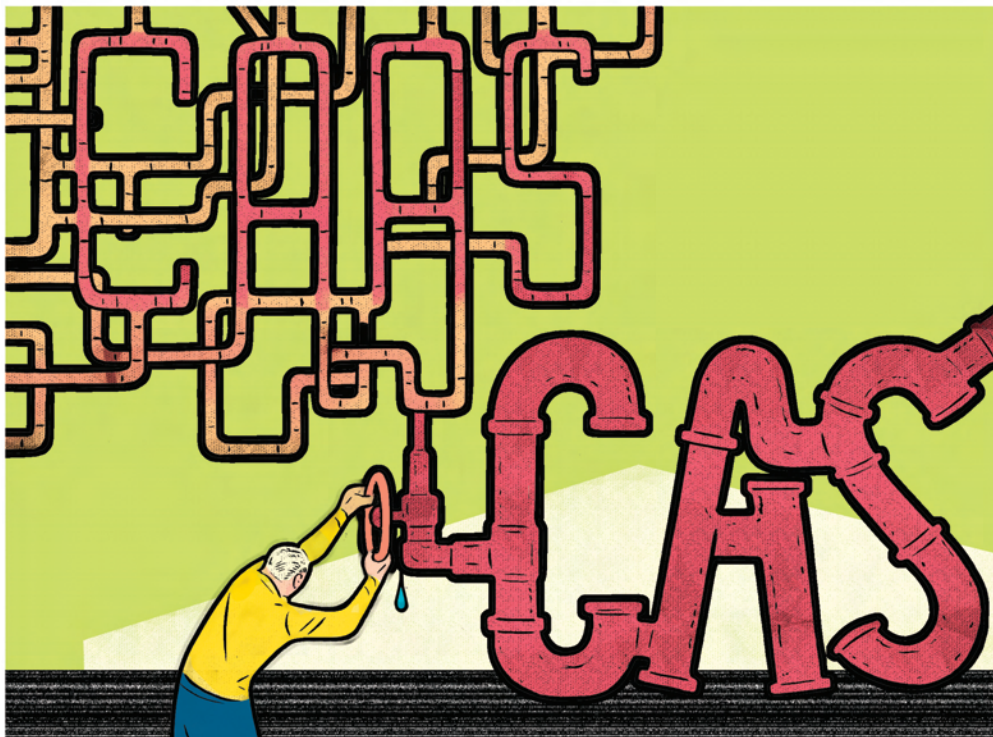
December 14, 2010, should comply with the new CAS. Early adoption of CAS is not permitted. However, auditors may perform procedures that exceed the requirements of GAAS if they wish.

Auditors therefore need to prepare now for upcoming audit engagements, given that all financial statement audits of entities with a fiscal year beginning January 1, 2010, will have to be performed in accordance with CAS.

Expected impact

Areas of financial statement auditing where current Canadian GAAS are essentially unchanged are:

- compliance with professional ethics and auditor responsibilities;
- legal liability and corporate governance issues;
- understanding business entities and business risk;
- audit planning; and
- internal control evaluation and testing.



Furthermore, some significant standards in the current *CICA Handbook — Assurance* already closely mirror ISA. These standards deal with audit risk, fraud and audit planning. There are no material changes to standards governing other public accounting services and reports, such as review and compilation engagements, and engagements to perform agreed-upon procedures.

Major differences between CAS and current GAAS

The most significant changes that will result from the adoption of ISA as CAS relate to the standard auditors' report and certain audit situations such as group audits, estimates, related-party transactions, confirmations, use of experts and going concern.

Audit documentation – CAS 230

Good news: auditors will have more time to document their files. CAS 230 requires assembly of the final audit file on a timely basis, which would normally be no more than 60 days after the date of the auditor's report. Currently, Section 5145 requires the auditor to assemble a complete and final audit file within 45 days from the report release date or the date of substantial completion.

Communicating deficiencies in internal control – CAS 265

One of the requirements of CAS 265 is the communication of all internal control deficiencies noted during the audit. This requirement has a wider scope than its counterpart requirement under Section 5141, which calls for the auditor to communicate material weaknesses (and not all the deficiencies).

Auditing accounting estimates, including fair value accounting estimates, and related disclosures – CAS 540

This CAS contains more detailed and rigorous requirements than Section 5305: Audit of Accounting Estimates. CAS 540 introduces risk assessment procedures in accordance with the audit risk model, which are not present in existing standards. It requires the auditor to understand the processes, including relevant internal controls, used by management to make accounting estimates. The auditor is also expected to review the outcome of accounting estimates made in the prior period financial statements. In addition, where the auditor has determined that an accounting estimate gives rise to a significant risk, CAS 540 guides the auditor to consider how management has assessed the effect of estimation uncertainty. For instance, the auditor must evaluate whether the significant assumptions made by management provide a reasonable basis for the accounting estimate. If management has considered alternative assumptions or outcomes, why have they rejected them?

Related parties – CAS 550

While the current section adopts a risk-based approach for audits of related-party transactions, the new standard is procedures-based. CAS 550 requires the auditor to perform specific procedures to verify the completeness of related-party information provided by those charged with governance. Although the cur-

rent section suggests similar procedures, they aren't required.

The requirements of the new standard relate to understanding the controls management has established for related-party transactions, analyzing accounting records for transactions with related parties, considering the risk of fraud in related-party transactions, getting sufficient documentary evidence to corroborate management's contentions, and documenting the audit.

Going concern – CAS 570

There is currently no Canadian standard equivalent to CAS 570. It addresses the auditors' responsibility to evaluate the appropriateness of management's use of the going concern assumption in preparing financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern. CAS 570 identifies the procedures to be followed, for example when assessing whether an entity can continue as a going concern in the 12 months following the date of the financial statement and also when there is doubt regarding the entity's ability to continue as a going concern.

When there is material uncertainty regarding the entity's ability to continue as a going concern, the auditor should determine

Audits of financial statements for years ending on or after December 14, 2010, should comply with the new CAS. Early adoption of CAS is not permitted

whether the financial statement clearly indicates and describes the significant doubt about the entity's ability to continue as a going concern, management's plans to address it, as well as the potential consequences. In addition, a paragraph should be added to the auditor's report that highlights the existence of a material going concern uncertainty and draws attention to the related note to the financial statements.

Audits of group financial statements – CAS 600

There is no equivalent standard in GAAS. CAS 600 introduces many new concepts, and its application will require a significantly increased work effort from that required by current Section 6930: Reliance on Another Auditor. Some examples of the additional work under CAS 600 are that the group engagement team is required to establish an overall group audit strategy and develop a group audit plan that will be reviewed by the group engagement partner. This same team is expected to obtain an understanding of the group, its components and their environments.

This CAS provides more explicit and extensive requirements on the consolidation process, subsequent events, and communications with component auditors, management and those charged with governance of the group. Therefore, in cases where the auditor of the consolidated entity isn't the auditor of all major components, this new standard will doubtless have a significant impact.

Using the work of an auditor's expert – CAS 620

CAS 620 deals only with the use of the work of the auditor's

expert, unlike the current standard that addresses the work of an expert, regardless of who has done the hiring. CAS 620 provides more explicit requirements, for example on obtaining an understanding of the expert's field of expertise and on providing direction and communication to the expert. The new standard requires the agreement with the auditor's expert to be in writing. In addition, changes will be made to CAS 500: Considering the Relevance and Reliability of Audit Evidence, in relation to the auditor's use of the work performed by management's experts.

Standards governing the independent auditor's report on the financial statements – CAS 700, CAS 705 and CAS 710
Significant changes will be made to the auditor's report:

- the structure and wording of the standard report;
- the requirement that the auditor comply with ethical requirements regarding the new report;
- the requirement that the auditor's report be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements. For this purpose, the date of approval of the financial statements is defined as the date on which those with the recognized authority assert that they have prepared the entity's complete set of financial statements, including the related notes, and that they have taken responsibility for them. In practical terms, this means the date of the auditor's report will be no earlier than

the date of approval of the financial statements in final form by the directors. This represents a significant change from current standards, under which the date of substantial completion of the auditor's examination is used as the date of the auditor's report. This change will have an impact on the representation letter, the independence letter, legal confirmations and audits of subsequent events. The further the reporting date from the date of substantial completion, the greater the need for additional audit work. Consequently, audit fees will increase.

Conclusion

The mentioned changes are not a complete list. They do not take into account certain differences that could be more important for some and less for others, depending on the situation of each auditor. The upcoming changes represent another major challenge for today's auditors and for all preparers of financial statements that need to be audited. Auditors and preparers should familiarize themselves with CAS as soon as possible to understand the potential impact of this transition on the audit process.

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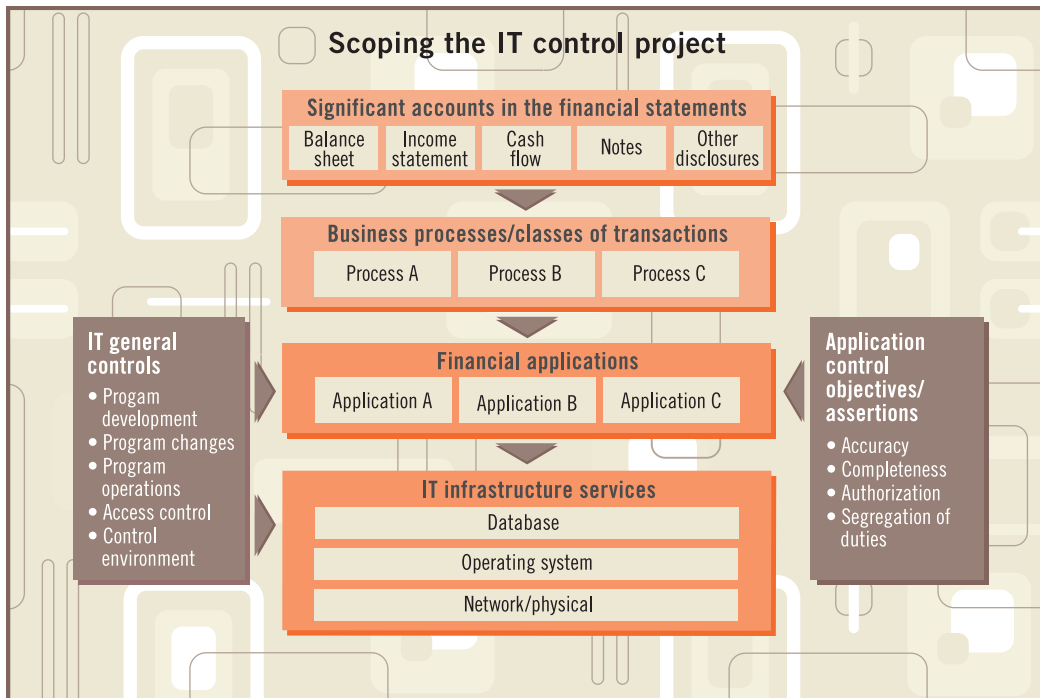


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Applying IT controls

When it comes to IT general controls as a prerequisite to reliance on application controls, there's a difference of opinion



Source: IT Control Objectives for Sarbanes-Oxley, 2nd Edition. ©2006 IT Governance Institute

Financial and information technology managements are faced with competing, complex and confusing standards and guidance on how to evaluate the design and operating effectiveness of IT application controls. An application control — a user's transaction processing limit, for example — must function within a secure, trustworthy computing environment (i.e., the surrounding network, server hardware and operating systems) for it to work. This is what placed in operation means, and it is required before an IT application control can be considered to be designed effectively.

There are conflicting opinions and guidance regarding whether effectively designed and operating information technology general controls (ITGC) are a prerequisite to reliance on application controls that provide

key internal controls over financial reporting.

Corporate management, CAs, audit committee members and IT security and control professionals need to debate the minimum ITGC requirements to support a conclusion that an IT application control is designed effectively and has been placed in operation.

The conceptual and practical problems lie in the situation where apparently strong application controls operate in a weakly controlled computer environment — for example where accounting system packages are installed on a computer server within a local area network (LAN) where the LAN and server operating system and database management system password rules are weak, little or no logging and review of possible unauthorized activity takes place and too many people have LAN and server administration privileges. This happens in small and medium organizations, and in a few large ones from time to time.

The importance of ITGC

On one side there is the point of view of the Financial Executives International Internal Control Evaluation Framework, published in December 2004 and incorporated into the Public Company Accounting Oversight Board's Staff Questions and Answers, Auditing Internal Control over Financial Reporting, issued November 22, 2004. Question 35 of this document makes the following claim: "IT general controls, by their nature, do not affect the company's financial statements directly."

On the other side is the following:

- *CICA Handbook* Sec. 5141.054: "Obtaining an understanding of internal control involves evaluating the design of a control and determining whether it has been implemented. Evaluating the design of a control involves considering whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatement."

- *CICA Handbook* Sec. 5141.060 notes that IT poses specific risks to an entity's internal control, including (among others) reliance on systems or programs that are inaccurately processing data or processing inaccurate data; unauthorized access to data that may result in improper changes to data, including the recording of unauthorized or nonexistent transactions; and most importantly, unauthorized changes to systems or programs, or failure to make the necessary correct changes to systems or programs.

- AU Sec. 319, Consideration of Internal Control in a Financial Statement Audit, also stresses that ITGC risks need to be considered when evaluating the design effectiveness of application controls, and concludes that the nature and characteristics of an entity's use of IT in its information system affect the entity's internal control.

- The CICA IT Control Guidelines (3rd Edition) also disagree with the approach suggested by the working group in the evaluation framework: "For reliance by management or auditors to be placed on fully automated control procedures or computer-assisted control procedures, general computer controls must be implemented and operating consistently and reliably. If they are not, there can be no assurance that fully automated and computer-assisted controls continue to operate as designed. Fully automated and computer-assisted controls do not compensate for weak general computer controls. If the condition of general computer controls is less than satisfactory, greater assurance must be sought from manual control procedures that do not in turn require assurance from general computer controls."

- In July 2004, the CICA Information Technology Advisory Committee issued a white paper, "IT Control Assessments in the context of CEO/CFO Certification." It states, "IT controls are

fundamental to the reliability and integrity of the information processed by the automated systems on which most organizations are dependent for their business and financial transaction processing — and overlooking or minimizing their importance creates a significant risk. The effectiveness of other controls, particularly manual controls, is also more often than not dependent on the effectiveness of IT controls."

The key point here is that it must not be assumed that an IT application control has any inherent correctness or integrity within it (given the past 50-year history of application bugs and human errors in coding resulting in the best practice of, at the minimum, three errors in every 1,000 lines of code). Further, inherent consistency of IT processing over time must not be assumed because this requires the IT application control to be located in a well-managed and nonhostile processing environment. These assumptions are dangerous to make when trying to obtain a high level of assurance about the financial statement integrity of an IT application control. The position that IT (application) controls are inherently more consistent than human behaviour is not necessarily true. The inherent risk of human error still exists, not in day-to-day manual transaction

There are strong arguments supporting the position that application code needs something else to breathe life into it. By itself, it is mere lines of characters on a page

processing, but in the human errors contained within the code that automatically processes the transactions and possibly in the operation of the computing system. There is merely a shift of the inconsistency of human behaviour involved in the transaction processing from one point (i.e. manual transaction processing) to the design, coding and operation that automate the work steps and integrate that application code with enough other technology to give it life.

There are strong arguments supporting the position that application code needs something else to breathe life into it. By itself, application code is mere lines of characters on a page (source code) or a string of zeros and ones (executable code).

Design and implementation

Unless the application function that provides the internal control (an exception report, for example) is properly implemented, we cannot say it is designed effectively. Where do you implement code? For typical computer systems — comprising an operating system, a database management system and some sort of network connection — don't assume inherent consistency of IT processing over time unless the IT application control is located in a well-managed and nonhostile processing environment.

The assumption that IT application processing is properly implemented and inherently consistent is valid only if: ITGCs are in place to ensure that application code logic has appropriate integrity through proper design, coding and testing; and the application code is kept safe through operationally effec-

tive controls over changes to the code and access to the data the code manipulates to produce expected results.

Safe environment

You need to trust the application systems and to do that, you need to trust the IT infrastructure to keep the data and programs safe from unauthorized and untested changes. Automated controls need a safe house within which to operate. If proper evaluation of internal control design effectiveness requires that the identified control is not only correctly designed on paper but placed in operation, then where else is an application control placed if not into what is commonly called a computer environment? Application controls do not operate in a vacuum. An operating system has to translate the application instructions into machine instructions, perform arithmetic and logic tasks, and provide the result back to the application. The application code does not operate in isolation. The safe house is needed for the application system to do its work and satisfy the user's needs, and a control architecture brings it all together.

How to break the problem down

The diagram on page 43 was developed by the IT Governance Institute (www.ITGI.org) in its research document "IT Control Objectives for Sarbanes-Oxley" to provide guidance on how to plan and scope the evaluation of IT general controls within a financial reporting context.

The diagram uses a layered view of the financial reporting process to guide management and auditors in decomposition of the information processing components that result in financial reports. The layered view breaks down the technology and process components so they can be readily understood and evaluated.

The key point of this diagram is to show the different layers needed to interact to produce financial reports that have integrity. Management and external auditors can document and evaluate each layer in the diagram and bring these results together in what might be called a horizontal approach. Or, they may consider the information system to be a vertical slice of each of these layers. In this case, the data is entered into an identified system that includes the application and its underlying database

management and operating systems, and relevant parts of the network are evaluated as a whole to determine whether or not that system performs its functions correctly and the relevant application controls are designed effectively. This is the vertical approach to analyzing the information system and associated internal control.

Whether you take a vertical or horizontal approach, eventually all the applications that are significant for financial reporting or any other business purpose, and the underlying infrastructure, have to be evaluated in order to understand the control risks that may exist.

All applications need trustworthy IT infrastructure (operating systems, database management systems, networks) to manifest their destiny and to breathe life into their lines of code. The applications need the overall infrastructure (the horizontal point of view) or the IT infrastructure specific to the application (the vertical point of view) to function in a secure and trustworthy manner. Primarily this means authentication of users, access control or privilege management, and control over changes to systems.

Organizations that continue to develop, acquire and implement new application systems to meet the changing business user needs require a mature set of IT infrastructure processes and technologies — one that provides a secure processing environment for all applications and gives the chief information officer and the organization an efficient and effective way to rise to the challenge of establishing trustworthy application systems processing to meet management and regulatory needs.

From an audit standpoint, it's not sensible to evaluate IT application controls as designed effectively without first figuring out if important ITGC, such as how changes are made and what access the users and IT personnel have, are free of material weaknesses and are operating effectively.

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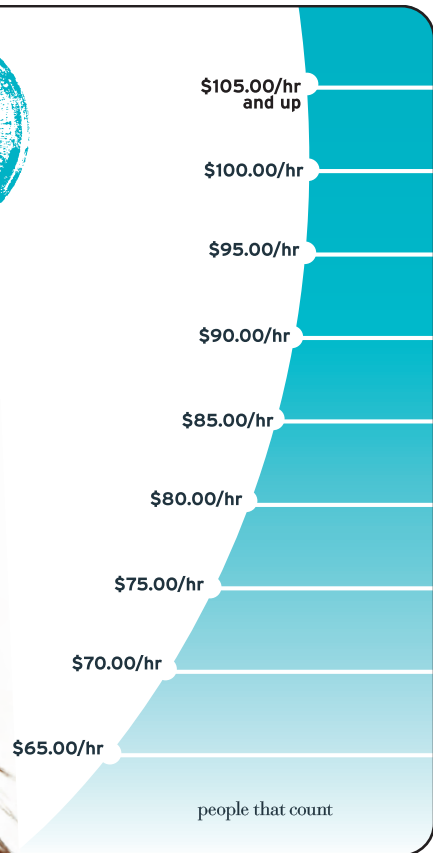
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Productivity and innovation

Canada is experiencing a major problem with productivity — the primary determinant of a country's standard of living. For the past 20 years, Canada's productivity gains have been well below that of the US, so it's hardly surprising that our standard of living is now 80% of that enjoyed south of the border, even though they once hovered close to parity.

Innovation is the main driver of productivity growth, so does this mean that Canadians are less innovative than Americans? Unfortunately, yes, but it is difficult to explain why. I recently participated in a roundtable with experts who examined this issue at the request of the federal government. We were able to shed some light on the matter.

Innovation involves a change that creates value — either a new product or a more efficient production method. Canadians appear to be as inventive as Americans when it comes to developing new products. Whether it's the BlackBerry or Cirque du Soleil, we have a fair share of innovations that upset the established order and open new markets. But such successes are only a tiny percentage of the slew of innovations that, year after year, drive economic growth.

Actually, most innovations are improvements to existing products — to their features, the production process and even distribution. Canadian companies perform less well when it comes to such innovations. Why is that? Canadian companies seem more reluctant to differentiate themselves through innovation. Our businesses are too often satisfied with imitating what's been done elsewhere, and only when pressured by competition. Why do Canadian companies do this, while US ones choose to compete against one another through innovation?

The small size of the Canadian market (one-tenth of the US) protects it partially from the more intense competition from US companies, which hesitate to cross the border (e.g. Target stores) or prefer dealing with Canadian distributors, as is the case for US TV shows. Despite the free trade agreement, a good half of the Canadian market

is relatively closed, and companies feel no obligation to invest in innovation to compete and are satisfied with higher costs or slightly outdated products. This mind-set results in lower Canadian productivity than in the US.

This complacent attitude on the part of businesses contrasts with our governments' eagerness to support R&D in hopes of spurring innovation. The problem with this R&D approach is that it's not as effective an innovation stimulus as some would like to believe. Contrary to what might be expected, R&D does not necessarily result in innovation, as it is only one factor involved. In fact, many innovations do not require R&D. Moreover, the type of R&D that leads to innovation rarely takes place in government-subsidized labs or at universities.

The problem with an R&D approach is that it's not as effective an innovation stimulus as some believe

Given that the cause and effect relationship between R&D and innovation is tenuous, governments should rethink their innovation strategies, which are now too R&D-centric. R&D is useful because of the knowledge derived from it, but there is a big difference between advancing knowledge and achieving economic innovation.

The widening productivity gap between Canada and the US is great cause for concern. Canada's challenge will be to persuade companies to compete against each other through innovation. Putting less emphasis on traditional R&D-based policies would be a step in the right direction. Instead of only subsidizing R&D, public policy should aim at encouraging experimentation and change. Public policy could also aim to make it easier for new competitors, both Canadian and foreign, to enter sectors that are sheltered from competitive pressures and in which companies feel little need for innovation. Stimulating competitive innovation could definitely contribute to narrowing the productivity gap between Canada and the US.

Marcel Côté is founding partner at SECOR Consulting in Montreal

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