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# RETAIL therapy

The CEO behind Canadian Tire Corp.'s record profits

Stephen Wetmore, CA



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# The great Canadian turnaround

What a year — the Tire records best-ever earnings and corporate Canada survives IFRS

According to Wikipedia, Canadian Tire is Canada's largest retailer; 90% of Canadians live within a 15-minute drive of a Tire store, and 40% of us shop at the store every week. In 2011, in the midst of a worldwide recession, Canadian Tire Corp. recorded an annual profit of \$467 million — its highest ever — and sales jumped 12% to \$11.6 billion. Should anyone be surprised that the Canadian icon is headed by a CA?

Stephen Wetmore was appointed CEO of Canadian Tire Corp. in January 2009. The recession was taking a huge bite out of the company's profits and earnings per share hit their lowest ebb in four years. So what did he do to achieve such a stunning turnaround? We sent freelance writer Paul Brent to find out. "Behind the New Brunswick native's calm demeanour," he writes, "lurks a fierce competitor and chief executive who does not hesitate to make sweeping organizational and strategic changes to a business." Wetmore is described by colleagues as "a natural leader." Find out more about how Wetmore transformed and is transforming Canadian Tire in "How to make Canadian Tire money," p. 20.



It's been a year and a half since publicly accountable enterprises in Canada replaced GAAP with IFRS. What happened in the first year? Did the accounting sky fall and irrevocably destroy the Canadian economy in the process? Was IFRS so daunting and confusing that everything clogged up and no business or investing was done? Not at all, reports writer Robert Colapinto in "IFRS report card," p. 26. "It seems that the post-GAAP conversion has gone off rather well," he writes. "Other than concerns [and complaints] about the volume of explication now required for IFRS compliance, regulators agree that PAEs are adapting to the new standards." Colapinto also investigated ASPE, also adopted on January 1, 2011. The story appears to be the same. Everything is going well.

In this issue Marcel Côté writes about innovation. He points out that competition is the prime mover of innovation in any industry. However, competition is not enough. Business also has to choose to innovate. Jim Carroll writes about the exponential growth of data usage and the business plan of Internet providers that have data plans that track every byte used. Why not save money by having a simple flat fee?

We have regulars on personal financial planning ("The ticking time bomb," p. 32); education ("Reviewing rotation," p. 36); fraud ("Pray and prey, more than homonyms," p. 39); assurance ("Assuring success," p. 42); and business valuation ("So beautiful or so what," p. 44).

Happy reading.

Okey Chigbo, Editor

## upfront

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Montreal's Stéphanie Saint-Denis is a keeper of traditions and has followed in her family's footsteps. Like her grandfather, father and brother she is a CA. And like her grandmother and a great-aunt she has taken over the reins of a workshop-boutique making high-end chocolates

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Since getting into the driver's seat three years ago at the country's iconic retailer, Stephen Wetmore has the company firing on all cylinders and earning record profits. Behind his calm demeanour lurks a CEO who doesn't hesitate to make sweeping organizational changes

BY PAUL BRENT

### 26 IFRS report card

January marked the one-year anniversary of the implementation of IFRS. Have things turned out as expected? Have there been any serious glitches? Here's an update since our first-quarter look at the new standards, accompanied by a short review of ASPE

BY ROBERT COLAPINTO

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So beautiful or so what: when putting your name on a valuation, if the brand is good, own it; if it isn't, then value and price are not the problems **By Stephen Cole**



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# Mailbox

## FOR GOOD GOVERNANCE'S SAKE

I was a bit surprised to learn in “The central flaw of good governance” (Outlook, March) that Marcel Côté, whose articles I nearly always enjoy, thinks that the media tend to focus on secondary criteria in their analysis of governance practices and that in particular, shareholder return is the prime objective of good governance. A company might treat its employees appallingly and pollute the environment in order to improve shareholder return; however, this behaviour would hardly be considered good governance.

In fact, Côté’s observation conflates the respective responsibilities of management and the board of directors. It is management that is responsible for shareholder return, not the board.

The board is responsible for ensuring management has robust processes in place that will enable it to meet corporate objectives while adhering to best practices in corporate, social, ethical and environmental standards and formal laws, as well as being accountable to the company’s stakeholders, not just its shareholders. This is, no doubt, what the media are trying to measure.

**Adam Plackett, CA**  
Toronto

Côté got it exactly right. It’s the return to the investor that counts, not how many highly paid rubber stamps are on the board. All a small investor can do is sell, or perhaps not buy. It’s really up to the institutional investors to do something about this.

As a small investor, I am appalled when management takes 30 to 40 pages in the annual report to explain how fair its compensation is. If it’s that complicated, I feel sure the shareholders are being ripped off.

The best way to align management in-

terests with shareholders’ interests is for a large part of the management pay package to be in company stock at market value (which they should not be allowed to sell for five years). Stock options won’t do it because, when the price of the company’s stock goes down, the company just cancels the old options and issues new ones at the lower price.

The new mark-to-market accounting rules lead, in many cases, to misleading reporting. A company that has long-term sales contracts and has fixed its costs with similar long-term purchase contracts, and perhaps eliminated the currency risk with futures contracts, should not have to report wildly fluctuating profit figures because of speculative price movements. The investor has the job of eliminating this mark-to-market effect to assess how the company is really performing.

**Gordon Vineberg, CA**  
Montreal

## ADDING TO “THE LODE”

In “Leveraging the lode” (Taxation, March) on government financial assistance it states: “Discretionary incentives typically have limits on the amount of total government funding that can be accessed for a given project. These limits usually do not include tax credits.”

I would like to clarify that the Treasury Board of Canada Directive on Transfer Payments (grants and contributions are considered to be transfer payments) specifies that “departmental managers are responsible for establishing a stacking limit in the terms and conditions for a transfer payment program, setting the maximum permitted level of total Canadian government funding under that program for any one activity, initiative or project of a recipient.” According to the directive, among the types of federal, provincial, territorial and municipal funding that must be consid-

ered for stacking purposes are “investment tax credits to which the applicant would be entitled.” This includes tax credits for capital-cost acquisitions as well as scientific research and experimental development tax credits.

**Jack Noodelman, CA**  
Montreal

## MORE WORDS ON STATEMENTS

“A few words on statements” by John Lorinc (March) was a very good article. It is good that it was written by someone who isn’t a CA; it was simple and frank.

Small practitioners hear this kind of comment all the time from clients, from mom-and-pop shop owners to somewhat more sophisticated users. I am sure even large firms with large clients might say that nobody pays much attention to three-quarters of financial statements once they leave their offices. Accountants, supposedly proponents of efficient economics, should not be expending inordinate resources to create things that get little or no use.

The needs of 90% of potential users should dictate content. Users requiring detailed information on specific matters should be able to read that information under separate engagements so that the 90% can get the information useful to them presented in an understandable and uncluttered way.

I hope the article sparks a debate on this topic.

**Gene Cholkan, CA**  
Etobicoke, Ont.

## A REALISTIC TOUCH

As a published author, I praise the realistic tone of “The write touch” by John Shoemsmith (April). Very few writers can boast about living off their creative works, a



reality accurately conveyed in the article.

I'm co-author of a book on personal balance entitled *Évitez le burn-out et trouvez l'équilibre* and author of three novels (*Le mirage d'une passion*, *Le masque de l'amour* and *L'envers de l'inconnue*). Accountants-cum-writers must shift from columns of figures to lines of words. Only through conviction can they take a chance, conquer their fear of the word and the message, and humbly accept inevitable criticism and inescapable rejection.

Though a book may generate interest, success is not guaranteed. Aspiring writers have to sell more than a few thousand copies before they can quit their day job. This market reality is accentuated by the French factor, not to mention the vast selection available to readers in bookstores.

Now that I'm in the twilight of a 40-

year career, I know I will resume writing because it's a great hobby, an outlet for thoughts that go beyond debits and credits and, above all, a dream come true.

There's a gap between dream and reality, and the sense of satisfaction that comes from bridging that gap is priceless. Today, I proudly include this achievement in my CV because it is part of what defines me.

**François A. Gouin, CA, CIRP (ret.)**  
Ottawa

#### Erratum

In "Waste watchers" (May), there were some factual inaccuracies and omissions:

- Jacques Bergeron did not *publicly accuse* anyone.
- We did not point out that Bergeron's case is still before the courts, information

that is important in understanding the context of the events in question.

- The word "vetted" was used to describe Bergeron's audit engagements, and while we can see how that can be misconstrued to mean giving approval, that was not our intent.

*CAmagazine* regrets any embarrassment the above may have caused Jacques Bergeron.

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# UP FRONT

News, people, briefs, trends + tips

## Chocolate legacy



**Just like grandma used to make: Montreal CA Stéphanie Saint-Denis is proud to run her family's 70-year-old chocolate shop**

**T**radition matters to Stéphanie Saint-Denis. Five years ago, the 43-year-old CA took the reins of Montreal's Chocolats Andrée, a workshop-boutique founded in 1940 by her grandmother Madeleine and her great-aunt Juliette. Offering 45 varieties of high-end chocolates, Saint-Denis does her utmost to please the shop's first-, second- and third-generation customers. "I often refer to Aunt Juliette's old recipe books," she says. "The best compliment I can receive is when a customer tells me that the chocolates haven't changed."

Interestingly, it was the men in her family who Saint-Denis followed at the start of her career — her paternal grandfather, father and brother were all CAs. But after working for nearly 10 years in public practice and another seven in industry, she thought about moving her career in a different direction. In 2007, Saint-Denis accepted her grandmother's earlier offer to take over the chocolate shop she often visited as a child with her mother.

Careful not to make any missteps, Saint-Denis worked 18 months under the watchful eye of her grandmother, who taught her all the tricks of the trade. Everything is handmade with care. Each chocolate egg, for example, is dipped in its coating before the final touches — such as an intricate signature or decorative treble clef — are added to the confections. The microbusiness bustles during Christmas, Valentine's Day, Easter and Mother's Day. "We generate 65% of our sales between November and May," says Saint-Denis. "Our multi-ethnic clientele is mostly from the Greater Montreal area, but we also cater to customers in Toronto and Vancouver."

Saint-Denis' CA training is a valuable asset for the successful business owner. "Making chocolate requires discipline and rigour," she says. "When there's a problem, I break it down to a management and numbers level."

Marie-Josée Boucher

### Is technology to blame for excess spending?

The road to debt may be paved with digital technologies, according to a survey by the American Institute of Certified Public Accountants. Four in 10 (41%) US adults polled buy digital products or services, with those subscribing to digital services spending an average of US\$166 each month — or 17% of their monthly mortgage or rent payment — for cable TV, home Internet access, mobile phone service, satellite radio and streaming video. Those who download songs, apps and other products fork out an additional US\$38 per month, on average.

Not surprisingly then, 56% of respondents say technology makes it easier to spend money while just 3% say technology makes it easier to save. Indeed, if facing a financial crunch, the majority of those polled would rather change what they eat than give up their cellphones, downloads or digital TV services.

*Tamar Satov*

#### Résumé

- 1990** joins Samson Bélair/Deloitte & Touche, Montreal
- 1993** obtains CA designation (Quebec)
- 2000** hired as analyst at Transport Canada, Montreal
- 2007** becomes owner, Chocolats Andrée

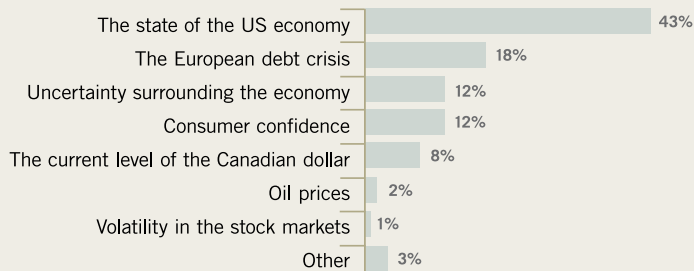
## LOOK SOUTH TO SEE OUR FUTURE

A dismal economy for our neighbours to the south is seen as the most significant obstacle to prosperity here in Canada, according to a CICA/RBC Business Monitor survey. Of the 320 executive-level CAs polled in the first quarter of this year, 43% say the state of the US economy is the strongest challenge to Canadian economic growth. Furthermore, 63% of respondents believe a US recession would have a negative impact on their company.

In comparison, just 18% say the European debt crisis is the biggest challenge to growth in Canada, followed by uncertainty surrounding the economy and low consumer confidence, each cited by 12% of respondents. The current level of the Canadian dollar rounds out the top five with 8% of the response.

The good news is that only 22% of respondents expect the US to slip back into recession within the next six months — a much rosier outlook than just two quarters ago when that figure was at 66%. Even fewer (8%) believe Canada will fall into recession within the next six months and, even if it does, the majority (61%) says their company is prepared for another recession. Of those, 69% say they have prepared for a downturn by building

### Biggest challenges to Canadian economic growth



Source: CICA/RBC Business Monitor, Q1 2012

adequate cash reserves, 61% improved efficiencies of scale and 44% reduced debt.

The survey also found 32% of executive CAs are optimistic about the Canadian economy for the next 12 months. While that is up from 20% in the last quarter of 2011, it is still down from 64% a year ago. Those who were optimistic attributed their outlook to low interest rates (74%), their company's performance (50%) and their company's earnings (44%).

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



### ASK AN EXPERT

#### WHAT'S THE BEST WAY TO INTEGRATE NEW EMPLOYEES INTO MY TEAM?

**Without some type of onboarding process, new recruits may not connect with the company's culture and values or become productive as quickly. Employee-orientation programs lay the groundwork for a smoother start to the job. Here are five tips for managers to help new hires acclimate:**

**Provide a roadmap.** Tell employees what they can expect in the first few months. Address topics they need to learn, review core job responsibilities, explain top priorities and high-light performance goals.

**Assign a mentor.** Mentors can shorten the learning curve, allowing new hires to make more substantive contributions early on. Being linked with a supportive adviser also gives them a stronger sense of belonging and accountability.

**Be welcoming.** Personally greet new hires on their first day and go out of your way to reiterate how happy you are they joined the team.

**Ease anxieties.** Encourage questions and offer introductions. Schedule a departmental lunch to give newcomers a chance to get to know coworkers in a less formal setting and establish rapport.

**Arrange day-in-the-life tours.** In their initial weeks on the job, ask new employees to meet with and observe key colleagues they will be working with across the company. This will enable them to learn who does what and gain a broader understanding of the organization.

Max Messmer is chairman of Accountemps and author of *Human Resources Kit for Dummies* ([www.accountemps.com](http://www.accountemps.com))

# #NUMBERS Game

**4.5** Millions of Canadians who currently receive OAS payments. In 1952, 643,000 seniors received the benefit; 2.3 million did in 1981.

**8.2** Billions of dollars in long-term savings allegedly offered under a 1996 Liberal government plan to replace the Canada Pension Plan and OAS with a new Seniors' Benefit program. The idea was scrapped in 1998.

**40** Dollar amount of the first OAS benefit cheques. The "universal" pension program was introduced in 1952 by Louis St-Laurent's Liberal government.

**67** Age at which Canadians should retire, according to a 2010 paper by two Canadian academics. "A retirement-age increase leads to a more balanced distribution across generations of the

**Security lapse** Stephen Harper's Conservative government has announced changes to Canada's \$29-billion Old Age Security program. How OAS went from guaranteed to uncertain in three decades:



costs of population aging than a contribution-rate increase," they wrote.

**70** Percent of Canadians who disagreed in a March poll with the assertion "social programs, seniors' pensions and other benefits in Canada are more generous than we can afford to pay for."

**50,000** Dollars in annual income at which OAS benefits would begin to be taxed back, following 1989 federal legislation. "There is no question," said the National Council of Welfare, that "the clawback puts an end to universality."

**1985** Year the Conservative government proposed and then backed off de-indexing OAS. "You made us vote for you, then, goodbye Charlie Brown," one senior protesting the move told then prime minister Brian Mulroney. Steve Brearton

## Going Concern



**CAROL LEAMAN, CA  
PRESIDENT AND CEO  
AXONIFY INC.**

**COMPANY PROFILE:** Waterloo, Ont.-based tech startup Axonify produces software for employers to help workers retain training information, such as customer-service or safety procedures. Based on a behavioural-learning technique called "spaced repetition," the software hammers home content by providing staff with daily personalized trivia-game-style questions and information bites. Employees get incentives, such as cash or gift certificates, for participating. With a staff of 15, the company is positioned to top \$1 million in revenue by the end of the year. Customers include some of the world's largest retailers and the hospitality sector is a target market.

**HOT FACTOR:** Companies are eager to make training more effective — especially as they continue to incur major losses from employee errors in health and safety and inventory.

Employers are also embracing the growing trend of "gamification" for training because younger workers like game-based software that awards points for correct answers. Axonify has an additional edge in CEO Carol Leaman, who has a proven track record for developing successful technology companies — her last gig was CEO of web analytics firm PostRank, which was acquired by Google last year.

**COOL PROJECTS:** Axonify is revamping its software to provide employers with even more detailed data on what information their employees are retaining, and they'll soon be able to benchmark their training results against others in their industry. A mobile app is also in the works.

**IN HER OWN WORDS:** "I expect that Axonify will be a world-leading, billion-dollar company within a matter of years. No one is doing training this way and we're going to completely change the way employers think about reinforcing key learning points with their employees." Rosalind Stefanac

By Tamar Satov



## Comparing business costs across Canada

Moncton, NB, is the country's most cost-competitive city for business, a KPMG study finds. Based on 26 significant business cost elements, including labour, taxes, real estate and utilities, the study examines 16 featured Canadian cities and compares more than 110 cities in 14 countries around the world.

Calgary is the most expensive among the Canadian cities, but is still more cost effective than 42 international cities studied. Relatively high wages, suburban office-leasing costs, and electricity costs all add to Calgary's total cost picture, while low natural-gas costs represent a plus for Calgary.

Montreal, which ranks seventh in Canada, has the lowest business costs among the 30 largest cities (metro populations of two million or more) in Canada and the US; while Vancouver, ranked 14th, has the highest office-leasing costs among Canadian cities.

"Larger cities are more appealing for many companies to do business, but smaller regional cities clearly offer a more cost-competitive location for certain types of companies," says Brad Watson, partner, KPMG in Canada.

**Most competitive Canadian cities for business**  
(lowest to highest cost)

Rank	City	Rank	City
1	Moncton	9	Windsor-Essex
2	Fredericton	10	Saskatoon
3	Halifax	11	St. John's
4	Trois-Rivières	12	Toronto
5	Charlottetown	13	Edmonton
6	Quebec City	14	Vancouver
7	Montreal	15	Prince George
8	Winnipeg	16	Calgary

Source: KPMG's Competitive Alternatives 2012

## Is Gen X getting the squeeze?

Gen Xers just can't seem to catch a break. That disaffected group of Canadians born between 1961 and 1981 is losing ground at the office, even though it now makes up a "quiet majority" (55% to 60%) of the total workforce, a PwC report finds.

The report, which was prepared for the banking industry but can be extrapolated to other industries, shows that from 2008 to 2010, promotion rates for Gen Ys (born 1982-2000) held steady at about 20%, while promotion rates for baby boomers (born 1943-1960) fell to 3% from 5%. Meanwhile, Gen X promotion rates also fell (to 10% from 11%) "in what should be their peak years of upward mobility," says PwC's Philip Hunter.

With older workers staying on longer — many in senior roles — and younger employees with a hunger for advancement coming up from below, the potential for disaffection among Gen Xers is significant, the report concludes.

### CLUELESS ON COMPANIES

One in five US workers doesn't know what his or her CEO looks like, according to a CareerBuilder survey of 7,000 full-time employees. Perhaps even more surprising: more than two-thirds (68%) of those polled said they don't know how much their company generates in revenue each year.

### MAD MEN EFFECT?

After two decades of declining popularity, the job title of secretary is making a comeback. In a survey of 3,300 administrative professionals by the International Association of Administrative Professionals, 15% of respondents had "secretary" in their titles, up from 8% two years ago.

### SUSTAINABLE AND PROFITABLE

Values-based banks, which consider environmental and human needs, are delivering higher financial returns than mainstream banks, finds a report by the Global Alliance for Banking on Values. From 2007 to 2010, 17 sustainable banks studied had higher returns on assets and equity than 29 of the world's largest, most-influential banks.



# Netwatch

BY JIM CARROLL

YOUR GUIDE TO BUSINESS & ACCOUNTING ON THE INTERNET

## Why account for every byte?

I recently found myself at 37,000 feet on a flight from San Francisco to Toronto, Skyping with my son who is at university. After a brief “can you hear me now” exchange, the call signal adjusted itself and the quality of the video call became crystal clear. Say goodbye to one of the last bastions of refuge from the interconnected world.

Internet access on flights isn’t new; several carriers have featured the service for a number of years and I’ve been using the Internet “up in the air” for some time. What became evident to me on that recent flight, however, is the continuing improvement in the quality and speed of the connection. And that’s a trend for bandwidth overall, whether by satellite (as is the case on planes), cable/phone lines or wireless devices.

According to research firm IDC, Internet traffic will grow 32% per year from 2010 to 2015. We currently send about 46 terabits per second, and that should grow to more than 200 terabits per second by 2015. Cisco suggests total annual Internet traffic will grow to 966 exabytes by 2015.

Of course, such numbers can become meaningless without interpretation, so let’s just say we will be able to send the equivalent of a million four-drawer filing cabinets filled with 20 million pages — every second. Each year, we’ll send information equivalent to twice the number of words spoken by all humankind since the beginning of time. Whoa.

As our demands on the system grow, technologies behind the scenes will emerge to support huge transmissions of capacity. A recent IBM press release, for example, noted the company has developed “the first parallel optical transceiver to transfer one trillion bits — one terabit — of information per second, the equivalent of downloading 500 high-definition movies.”

Someday, we’ll have this type of bandwidth in our homes and on our mobile devices. Which brings me to accountants and wireless companies. Given the reality of these trends, why do wireless companies use a business model that deploys thousands of accountants at a cost of

millions of dollars to track individual bits of information and charge customers every time they go over a usage cap? I seem to be in a perpetual state of war with my wireless/Internet service provider. Our family has four iPhones — and we spend a substantial sum of money to support our data-driven lifestyle as well as a high-speed Internet connection. Every time we make some small change that involves an incremental adjustment in bandwidth, the fee goes up.

The approach of these companies seems to be that in a world of continuous bandwidth growth, they should track each and every byte. Couldn’t they save a ton of money if they just offered a simple flat-fee service that recognizes the reality of our times? They’d eliminate a bunch of sophisticated IT systems, the staff who supports them, the marketing staff who dreams up complex campaigns that revolve around bit-tracking, and the support staff who has to clean up the mess after the inevitable showdown with the customer when things (usually) go wrong.

Here’s the conundrum in a nutshell: Internet usage and capacity will continue to grow at an exponential pace. But the industry that handles the flow of data sees tracking individual bits as a critical part of the business plan. I’d say this is one of those industries where you really question the value of the accounting mind-set, don’t you think?

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

### HUNGRY FOR DATA

**Gogo inflight Internet** [www.gogoair.com](http://www.gogoair.com)

**IBM press release, “Holey Optochip”** [www-03.ibm.com/press/us/en/pressrelease/37095.wss](http://www-03.ibm.com/press/us/en/pressrelease/37095.wss)

**Cisco Global Mobile Data forecast** [http://newsroom.cisco.com/ekits/Cisco\\_VNI\\_Global\\_Mobile\\_Data\\_Traffic\\_Forecast\\_2010\\_2015.pdf](http://newsroom.cisco.com/ekits/Cisco_VNI_Global_Mobile_Data_Traffic_Forecast_2010_2015.pdf)



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# Work in process

BY MICHAEL BURNS

USING TECHNOLOGY TO IMPROVE THE WAY YOU DO BUSINESS

## CRM survey 2012

**C**ustomer relationship management (CRM) has now joined the ranks of mainstream technology and it's hard to find any organization that doesn't want or need it in some form or another.

And why not? CRM's raison d'être is to improve customer relationships, and what organization doesn't have customers? CRM covers the entire sales spectrum, from keeping track of customer contacts to selling, marketing and servicing. Moreover, as this year's CRM vendor survey shows, most products now include not only customers but all contacts, including suppliers and referral sources. (See [www.camagazine.com/CRMSurvey2012](http://www.camagazine.com/CRMSurvey2012).)

CRM used to be dominated by big applications from SAP and Oracle (which purchased the first CRM vendor, Siebel, in 2005). SAP and Oracle are still top players in CRM technology, partly because their customers want integration with those companies' ERP systems. But salesforce.com and Microsoft are now nipping at their heels. Salesforce.com was the first company to sell CRM using software as a service (SaaS) — a variety of cloud computing, where the infrastructure for supporting the software and the data is outsourced. SaaS is now considered mainstream as well, and just about every vendor is now playing catch-up to salesforce.com. Microsoft is also a market leader partly because it is best able to leverage Microsoft Outlook and other Microsoft products.

CRM is considered such a hot market that vendors are eagerly pumping R&D dollars into the technology and new vendors are emerging with more features and lower prices. Today the buzz is mostly about mobile CRM, social networks and CRM business intelligence (BI). Mobile CRM allows you to have CRM access on your mobile device but in a way that optimizes the small screen size. It should also mean you can work when disconnected from the central system on the web and resynchronize your data when reconnected.

Social networks such as Facebook and Twitter can

be used as a way to attract customers or to find out what existing customers are thinking. BI is all about turning data into information to make decisions and with a ton of CRM data, there ought to be some valuable information worth analyzing.

The two problems we hear most about CRM are the lack of integration with ERP and users' reluctance to use the technology. Integration is not just about linking contacts and customers between CRM and ERP. It also means making it possible for CRM to perform functions similar to those found in the order processing module of an ERP system. Lack of integration is also a problem if you need multiple reporting systems, workflow systems and security systems that all require different setup and main-

**CRM is considered such a hot market that vendors are eagerly pumping R&D dollars into the technology**

tenance. The lack of integration is addressed by some ERP vendors such as NetSuite, which have built CRM into the fabric of their solutions. Others provide links to the more popular CRM systems.

Users' reluctance to use CRM can't be fixed by technology, no matter how easy or intuitive the system. The problem is, many users don't want to spend time updating their CRM systems when they are judged and evaluated on other activities. As well, CRM can diminish the importance of certain people who use their knowledge as a source of power.

As with all our surveys, we were unable to validate the information supplied to us by the vendors. We don't think there will be that many intentional mistakes, partly because the vendors will lose credibility if they are caught making false claims.

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



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## CICA and CPAB launch stakeholder consultation to enhance audit quality

Since the 2008 global financial crisis, policy makers, regulators, standard setters and others around the world have been considering changes to the financial system to promote greater financial stability and to reduce systematic risk. Audit quality is among the factors being discussed, with major audit reform initiatives well underway by the European Commission; the United States' Public Company Oversight Board; the United Kingdom's Financial Reporting Council; and the International Auditing and Assurance Standards Board, which has launched a project on enhancing auditor reporting.

Canada weathered this crisis well relative to many other countries and did not experience the bank and other financial-system failures that are driving many of the changes to the audit process internationally. However, we will not be immune to audit changes taking place worldwide. Canadian businesses compete daily in the international capital markets and key elements of our financial reporting system, such as securities regulation and auditing and accounting standards, are linked internationally.

Recognizing that our nation will not be exempt from global audit reform, the Canadian Public Accountability Board (CPAB) and the Canadian Institute of Chartered Accountants (CICA) have initiated a research and consultation process to enable key stakeholders to discuss and determine Canada's perspective on the audit issues being deliberated at the world table.

"This is a pivotal time for the future of the audit," said Kevin Dancey, CICA president and CEO. "CICA and CPAB are partnering on this initiative so that Canada's perspectives are understood and heard wherever global audit quality issues are being discussed, whether in international forums or here at home."

The Enhancing Audit Quality: Canadian Perspectives consultation process will develop Canadian views about solutions and will seek to influence final outcomes with respect to strengthening audit quality globally.

To provide effective coordination and direction to this work, an enhancing audit quality steering group (chaired by

David Brown, a leading securities lawyer and former chair of the Ontario Securities Commission) has been established, along with three working groups, with experts from audit committees, auditing and assurance standard setters, auditors, investors, prudential and securities regulators, financial-statement preparers, CPAB and the CICA. The working groups will focus on three aspects of audit quality and reform being discussed internationally.

The working group on the role of the audit committee will focus on the reporting relationships between audit committees and their key stakeholders, along with enhancing and promoting professional skepticism by the audit committee and the auditor.

The working group on auditor reporting will target enhancing the information value of the auditor's report and ex-

**"CICA and CPAB are partnering on this initiative so that Canada's perspectives are understood and heard"**

panding auditor association with management disclosures outside of the financial statements.

The working group on auditor independence will focus its efforts on the options relating to the appointment and rotation of, and nonaudit services provided by, auditors that will improve independence, objectivity, professional skepticism and audit quality at firms.

Final reports on the consultation and stakeholder perspectives will be developed for use by Canadian standard setters, regulators and others as they consider potential changes to enhance audit quality and by those who represent Canada in international forums focused on audit quality. The final reports could also be used by CICA to develop guidance materials.

Look for discussion papers for comment starting this summer on auditor reporting and auditor independence. The role of the audit committee working group expects to release a discussion paper for comment later this fall.

Check out the opportunities to participate and share your thoughts on Enhancing Audit Quality: Canadian Perspectives by visiting [www.cica.ca/EnhancingAuditQuality](http://www.cica.ca/EnhancingAuditQuality) for information on the process, including documents and resources.

## New details about proposed CPA certification program available on CPA Canada website

**M**ore information on the proposed Canadian CPA certification program was recently released on the CPA Canada website. Developing the CPA certification program would be an immediate priority of the merged organization. The goal would be to create the certification program needed to produce Canada's pre-eminent professional accountants by drawing on the best of existing programs.

A diagram of the potential implementation of the CPA education program depicts all the steps including academic prerequi-

sites for admission; a post-graduate CPA professional education program; examinations, including a common comprehensive final evaluation; and relevant practical experience. In addition, a comprehensive FAQ section provides answers to questions about implementation and timing, specific elements of the program, practical experience models and other aspects of certification.

To find out more, visit [www.cpacanada.ca](http://www.cpacanada.ca) and go to the certification program section.

## SME advisers can take tips from *The Wealthy Barber*

**SME ADVISERS** are frequently asked for basic personal financial planning advice from their clients. But how do you provide such guidance when your clients possess varying levels of financial literacy? How can you communicate concepts that some of your clients are struggling with in simple terms?

David Chilton has found a way to discuss personal finances in a way that is readily understood by many through his best-sellers *The Wealthy Barber* and *The Wealthy Barber Returns*. Participants at CICA's 2012 National Conference for SME Advisors will have the opportunity to hear his approach and ask him questions to get tips on how to communicate

in a way that can be readily understood by their clients.

In addition to a session with Chilton, the conference will feature sessions dealing with the latest updates on standards and tax; the latest in IT practices and practice management concepts to help maximize efficiencies; succession planning and topics for advising your NPOs. There will also be sessions of interest to the Next Gen partner.

CICA's 2012 National Conference for SME Advisors takes place August 8 to 10 in Halifax.

For more information and to register, visit [www.cpd.cica.ca/SMEAdvisors](http://www.cpd.cica.ca/SMEAdvisors).

## Applying the standards? Check under the tab

**CICA's** revamped website includes a new section to help members implement new accounting and auditing and assurance standards. The Applying the Standards tab leads to a broad range of resources about new financial reporting and assurance standards for public and private enterprises and private sector not-for-profit organizations.

"There has been a significant amount of change in all accounting and auditing standards over the past couple of years," says Gordon Beal, CA, director of guidance and support. "The CICA is focused on helping members — particularly those working in small to medium-sized firms and organizations — cope with these changes. This new area of our website houses CICA resources as well as offerings from other credible sources to help members understand the finer points of working with the new standards."

The Applying the Standards area provides one-stop access to a growing range of webinars, guidance, events and education materials to support members in working with the standards. It includes many of the familiar resources that were featured on the former Canadian Standards in Transition web pages. Visit [www.cica.ca/ApplyingTheStandards](http://www.cica.ca/ApplyingTheStandards) for more information.

## CICA helps members stay on alert for new IFRSs

**CICA HAS INTRODUCED** a series of Reporting Alerts to help you stay up-to-date on new and revised IFRSs. The concise publications provide the basics of specific standards, describe key changes and help readers identify the possible impact. Geared toward smaller entities, the series is available for free download. CICA Reporting Alerts and links to other resources can be found at: [www.cica.ca/IFRS](http://www.cica.ca/IFRS) alerts.

# Standards digest Want to be kept informed? Log on to [www.frascanada.ca](http://www.frascanada.ca)

## RECENTLY ISSUED PRONOUNCEMENTS

<b>CICA Handbook – Accounting</b>	<b>Date issued<sup>†</sup></b>
<b>Part I</b>	
Amendments Regarding the IFRS Changeover Date for Investment Companies and Rate-regulated Enterprises	March and May 2012
Amendments to IAS 32 and IFRS 7 Regarding Offsetting Financial Assets and Financial Liabilities	May 2012
Amendment to IFRS 1 Regarding Government Loans	May 2012
Amendments to IFRS 9 and IFRS 7 Regarding Mandatory Effective Date of IFRS 9	May 2012
<b>Parts II and III</b>	
Amendments Regarding First-time Adoption	March 2012
<b>Part IV</b>	
Amendments Regarding Benefit Plans	May 2012
<b>CICA Public Sector Accounting Handbook</b>	
Handbook Improvements	March 2012
Amendments Resulting from Section PS 3450	March and May 2012
<b>RECENTLY ISSUED DOCUMENTS FOR COMMENT (to June 30, 2012)</b>	
<b>Accounting</b>	
ED 2012 Improvements to Accounting Standards for Private Enterprises	June 1, 2012
EDI Annual Improvements to IFRSs 2010-2012 Cycle	September 5, 2012
<b>Auditing and Assurance</b>	
ITC IAASB Plan for a Post-Implementation Review of the Clarified International Standards on Auditing	September 7, 2012

## WATCH FOR

<b>New or revised standards</b>	CSAE 3410: Assurance Engagements on Greenhouse Gas Statements Revisions to CAS 315 and 610: Using the Work of Internal Auditors
<b>Documents for Comment</b>	Auditor Reporting (AASB Invitation to Comment) Auditor's Consent to the Use of the Auditor's Report in an Offering Document (AASB Exposure Draft) Related Party Transactions (PSAB Exposure Draft)

### Legend

ED – Exposure Draft

EDI – Exposure Draft based on IFRSs

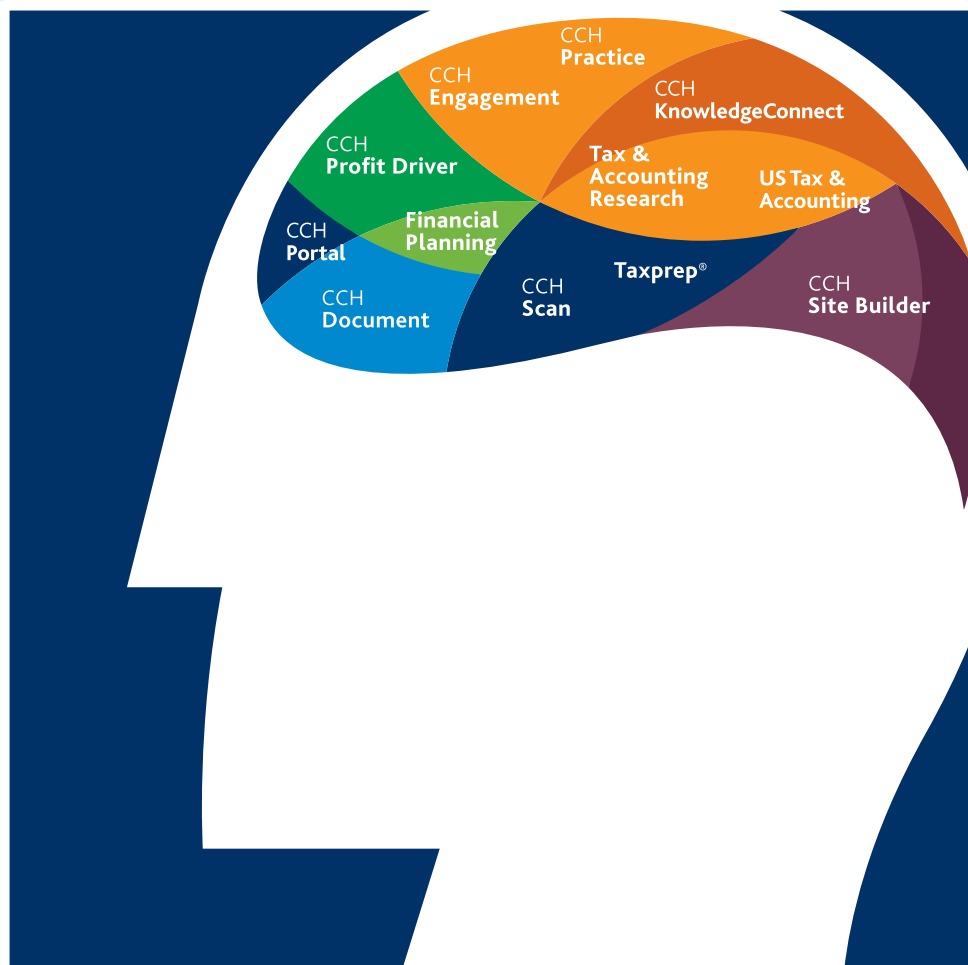
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<sup>†</sup> Refer to each Handbook pronouncement for the effective date and transitional provisions.  
*The information published above reflects best estimates at press time. Please visit our website for the most recent information.*



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Since getting into the driver's seat at the country's iconic retailer, Stephen Wetmore has the company firing on all cylinders

By Paul Brent

# HOW to MAKE »»» Canadian TIRE money

IN MARCH 2010, the recently appointed CEO of Canadian Tire Corp., Stephen Wetmore, met with George Vallance, owner of a Canadian Tire store in Burnaby, BC, and other Western Canada dealers as part of an inaugural cross-country tour. In his signature soft-spoken style, Wetmore told his audience that the iconic retailer and its independent owners/dealers had to forge a less-complicated, friendlier relationship if they were going to survive against the likes of Walmart and Home Depot. The new CEO, who had a bird's-eye view of the company for years as a director, struck all the right notes in his presentation, noting the Tire had branched out into so

Photography by EDWARD GAJDEL



Mr. Fix It: CEO Stephen Wetmore spent the past three years renovating the Tire, and his handiwork is producing results



**Wetmore is a fierce competitor** who does not hesitate to make sweeping changes to a business. If he didn't exactly take a chain saw to the company, he's been wielding something bigger than a scalpel — perhaps a Mastercraft skill saw

many businesses that its customers were uncertain what it stood for and promising to be as demanding with his own staff as he was with the dealers in refocusing the company. But it was during the post-meeting dinner that the new boss truly showcased his talent for bringing others onside with his vision.

“That was when the stuff came out on the table. He was remarkably candid and I just kept hearing [similar stories] from dealers across the country,” says Vallance, who is also a company director. “The feedback was he really has a good grasp of what makes the business tick [especially] for a person who doesn't come out of retail.”

The skill set necessary to alternatively motivate, cheerlead, cajole and persuade is almost uniquely required by a CEO of a company such as Canadian Tire, thanks to the 400-plus independent dealers who actually own and run the retail stores. More business partners than employees, these dealers must be convinced to make necessary changes rather than be told or ordered.

By all accounts Wetmore, a 59-year-old CA and former vice-chairman of Bell Canada with little previous retail experience, has succeeded in building a winning relationship with his dealers to a degree his predecessors could only dream of. “I would say the relationship is the best it has been in my 20 years,” says Vallance. “His ability to get everyone rowing in the same direction is unparalleled.”

But improving relations with dealers is just one of the many projects this busy Mr. Fix It has undertaken at the mass-merchandise giant, which includes Canada's top menswear retailer Mark's Work Warehouse, nearly 90 PartSource automotive stores, a chartered bank that has issued more than five million Canadian Tire-branded credit cards (accounting for more than one-third of annual profit) and, since last year's \$771-million acquisition of Calgary-based Forzani Group Ltd., some 500 sport retail stores with banners such as Sport Chek and Athletes World. In all, Canadian Tire Corp. has more than 1,700 retail and gasoline outlets from coast to coast employing 68,000 people.

Wetmore has spent the past three years renovating the Tire, with a dramatic reveal in 2011 in the form of record earnings. After stumbling in 2009, when recession-stunned consumers pulled back and profits were just \$335 million and earnings per share hit their lowest level in four years, the company recorded an annual profit of \$467 million in 2011, its highest ever and 5% higher

than the prior year, as sales jumped more than 12% to \$11.6 billion. A good portion of that sales bump comes from the inclusion of the Forzani Group (now called FGL Sports) results for part of the year, but even excluding Forzani, retail sales rose 6.6% for the year.

How did he do it? Behind the New Brunswick native's calm demeanour lurks a fierce competitor and chief executive who does not hesitate to make sweeping organizational and strategic changes to a business. “He is a natural leader,” says Canadian Tire's chairman and long-time company director Maureen Sabia, who served on the board with Wetmore for six years. “He disturbs the status quo with extraordinary finesse and with extraordinary politeness and with great candour.”

Indeed, Wetmore has already shuffled senior management a couple of times, centralized and simplified reporting to eliminate a series of independent fiefdoms that had sprung up across the organization and implemented systems to identify and deal with the many ways the retailer had fallen behind. If he didn't exactly take a chain saw to the company, he's been wielding something bigger than a scalpel — perhaps a Mastercraft skill saw.

“I have kind of ripped it apart and designed it so that I have 10 or 11 direct [executive] reports so that I can actually get involved,”

#### ONE MORE PERSON TO PLEASE

As Canadian Tire's CEO, Stephen Wetmore has a number of audiences he has to keep happy: customers, his staff, shareholders and the hundreds of independent dealers who own and operate the stores across the country.

And then there is Martha Billes.

The strong-willed daughter of company co-founder A.J. Billes, she wrested control of the company in 1997 from her two brothers, David and Fred. She was an unlikely heir to the Billes throne — her two brothers were groomed as possible successors to their father while Martha was expected to assume a secondary role.

Publicity shy, Billes is one of Canada's wealthiest women, has the final say at the Tire thanks to a 60% voting interest and keeps a close eye on her nest egg. She's the company's longest-serving director (32 years) and the only Billes on the board other than her son Owen, who owns a Canadian Tire store in Welland, Ont.

Despite the corporate matriarch's controlling stake, Wetmore says she does not wield undue influence over the board. “The board is very independent and we make decisions in the best interests of the shareholders and the company. She never interferes from that perspective,” he says. “I don't talk to Martha any more than I talk to any other board member.” —PB



says Wetmore. Previously, the CEO was in direct contact with half as many executives, mainly presidents running their own operations such as retail, financial services or the standalone Mark's Work Wearhouse chain. Wetmore also tried to untangle operations that had taken on a life of their own. "Our roadside assistance program was being run by financial services, another executive ran our parts business, PartSource was being run by someone else," he says. "We had five executives involved in automotive rather than one."

Another operational glitch the new CEO repaired was a glacial "time to market" performance. On average it took 14 months for Canadian Tire to identify a product and get it on the shelf; top competitors typically took eight months. That once-dismal delay has since been trimmed by up to 40% through the introduction of better information systems and a renewed sense of urgency.

The company's growth and internal reorganization under Wetmore, including changes to the way it reports its earnings, has led to grumblings by financial analysts that it is now harder to determine how its separate retail divisions are performing. Upon hearing that complaint, the CA in the CEO emerges: "If they were better with numbers, they would actually get more information than they used to get, which we are trying to explain to them." Integrating back-office functions, he says, has made it impossible to produce pure numbers by store banners, which the company did in the past.

Wetmore's CA background complements, rather than dominates, the abilities he brings as a CEO. "I would say he is fairly atypical of a CA," says Eugene Roman, who worked alongside Wetmore at Bell as group president, systems and technology. "He looks at the financials through the leadership lens and always challenges his team to look behind the numbers." For his part, Wetmore says he would not have chosen any other profession to begin his career and that his years as a full-time CA allowed him to examine the inner workings of hundreds of companies. These days, though, he leaves accounting matters to his CFO, who recently steered the company through the transition to IFRS.

That doesn't mean Wetmore ignores the numbers. For example, he ripped up compensation plans for the top 260 executives in the company who previously were paid based upon the overall results of the company and now are rewarded on their individual performances measured against set objectives. "I think culturally we have changed a lot, giving the right young stars the opportunity to show their stuff," he says. As for those who aren't pulling their weight, Wetmore is clear with his demands. "As soon as I see mediocre contributions being made by executives, either changes [happen] or we bring in somebody else. They are highly paid and perform or we can find somebody else. That is what shareholders want."

Wetmore himself is highly motivated to drive the company forward, as his annual salary accounts for \$1.25 million of his

# it takes one to know one



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In his early days at Coopers, Wetmore set an overtime record for a student. Today, his ferocious appetite for work sets the pace for the all-out, never-satisfied corporate ethos at the Tire. “We start meetings a little earlier than we used to,” he says with a grin

compensation, with the rest coming in the form of incentive plans and stock options. In 2011, he earned a total of \$6,620,572, making him one of corporate Canada’s better-paid CEOs.

Not bad for a small-town kid from Campbellton, NB, the youngest of four boys whose dad worked in the building supplies and construction industry. Even as a child Wetmore had high aspirations — he originally considered a career in medicine — and eventually he decided to pursue a degree in business administration. After graduating from Acadia University in 1976, Wetmore joined Coopers & Lybrand’s St. John office, earning his CA designation in 1979. Within a few years, he was leading the audit team for McCain Foods, the firm’s biggest account.

After seven years with Coopers and Price Waterhouse, Wetmore joined pharmaceutical company Scotia Holdings PLC. A year later he moved with his wife, Jann, to England with the company. It was there he developed his highly polished executive skills under the tutelage of then Scotia chairman Sir Ian Morrow, Britain’s legendary “company doctor,” a CA and management consultant credited with the turnaround of Rolls-Royce. “It was Sir Ian who pushed me to make a decision as to whether I wanted to stay in finance or move into operations,” Wetmore says. Operations won out and he eventually climbed the ranks to managing director.

Wetmore, his wife and their young daughter came back to Canada in 1993 and the CA ended up as CFO and later president of regional carrier Air Atlantic, guiding the company through bankruptcy and its eventual sale to the parent company of CanJet. In 1998, Wetmore moved into the executive suite at Newfoundland’s NewTel Enterprises Inc. as president and CEO, shortly before an initiative was launched to amalgamate the four Atlantic provinces’ phone companies. In an industry dominated by engineers, it was the accountant and industry newcomer who was selected over more veteran executives to run the newly combined entity, Aliant Inc., in 1999. He shone in the new role. When Bell Canada Enterprises increased its stake in the company to more than 50% at the end of that year, it brought Wetmore to the attention of the telecommunications giant’s top brass, although he was still a relative unknown on Bay Street. “Believe me, that’ll change. That’ll change,” predicted Aliant former chairman Charlie White in 2001.

From 2002 to 2008, Wetmore took on increasingly senior roles at BCE and was being groomed to replace Michael Sabia as CEO at the country’s largest telecommunications company. He eventually lost out on the top spot to former Telus Corp. CEO George Cope, setting the stage for his hiring at Canadian Tire, where he had been on the board of directors since 2003.

In his current role, Wetmore is the pacesetter for the all-out, never-satisfied corporate ethos at the Tire. He typically starts his day at 6:15 a.m. and doesn’t check out until after 7 p.m. “We start

meetings a little earlier than we used to,” he says with a tiny grin. That ferocious appetite for work is remembered well by his friend Mike Bishop, who worked with him in the early days at Coopers & Lybrand, where he set an overtime record for a student. “There was no one who worked like he did. Incredible work ethic,” Bishop says, adding that beyond the drive and capacity for long hours are a sharp mind and strong leadership qualities. “His people skills are second to none, very good boardroom skills.”

Wetmore is also highly accessible; company managers seeking a little face time with the CEO will often find him outside Canadian Tire’s Yonge Street office tower sneaking a quick smoke. In his Bell days he was famous for dragging colleagues outside, smoker and nonsmoker alike, to brainstorm ideas or talk about problems. To further motivate staff, he’s taken on the unofficial role of chief library officer, dispensing business and management books to his executives. “I will throw books around and say to people, ‘Here, have a read of this,’” he says. “I love the innovation ones primarily, because innovation is the key to having fun every day. That to me is how I get the best out of everybody.”

While it looks like Wetmore has, indeed, got his people — and the company as a whole — chugging along on all cylinders, new threats rise up continually for the 90-year-old Canadian retailing icon. Those threats can be obvious, such as the impending entry of US discount giant Target, or more subtle, such as the emergence of online tire sellers who have spirited away as much as \$75 million in annual tire sales from existing sellers without opening a single location in Canada.

In a business where standing still means falling behind rivals, the company is in the midst of a program to sell large appliances such as refrigerators at its stores, has pared back its female-focused marketing in favour of its traditional man-cave appeal, and is testing a new consumer-loyalty program that could lead to the demise of its iconic Canadian Tire money.

“As I told the dealers last year at our convention, you have to go on offence. [If] you play defence you are going to lose,” he says.

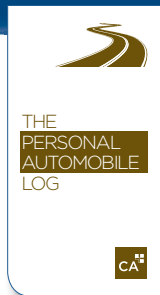
Vallance, who has a unique perspective as a dealer and board director, expects Wetmore will keep up the fast pace of change at the Tire, which was often criticized in the past as slow-moving and stodgy. “In the boardroom, as he does with his own people and a group of dealers, he knows what he wants, works extremely hard to get there and wants everyone to go with him,” he says.

New projects are met with support rather than skepticism at the board level given Wetmore’s track record as CEO, says the dealer. “He has really earned a fair amount of trust and freedom that only comes through results.”

Paul Brent is a Toronto-based writer and journalist

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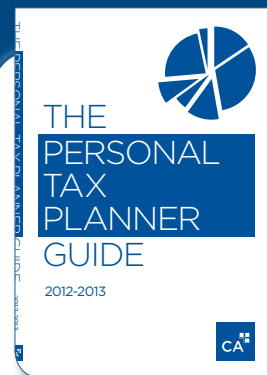


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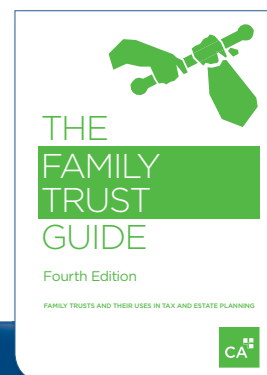
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THE FIRST ANNIVERSARY OF IFRS implementation has come and gone. So how did it go? Here's what a few companies had to say about their conversion

# report card

By Robert Colapinto

# IFRS

## MISSING IFRS 1 RECONCILIATIONS. OMITTED STATEMENTS

of changes in equity. Opening IFRS statements of financial position absent-without-leave. These were the most glaring deficiencies identified by the Ontario Securities Commission in its sampling of Canadian companies' first efforts at IFRS first-quarter financial reports for the period ending March 31, 2011. A bit of a worry until more robust second-quarter and third-quarter reports followed. These reports included the required transition disclosures in what is surely the most sweeping of bottom-line accounting changes to how Canadian public companies interpret and measure their financial performance.

illustration by MICHELLE THOMPSON



Transparency and comparability on a near-global scale have been understandably daunting, with glitches and missteps not unexpected. But for regulators and informed commentators, it seems that the post-GAAP conversion has gone off rather well. The business of continued refinement and proper interpretation of this almost entirely principles-based guidance continues as public companies grapple with the proper balance of informed judgment and compliance with IFRS.

For many publicly accountable enterprises (PAE), the final run-up to the IFRS transition bordered on the frenzied. The true magnitude of properly identifying the IFRS regime's new recognition, measurement and disclosure requirements was not realized until the PAEs really got down to it, says Karim Jamal, FCA, University of Alberta School of Business department

performance and "value" are, obviously, the key indicators to be divined through these new metrics. "Only problem," he says, "is that we're getting a whole whack-load of words that may, quite unintentionally, obscure." Prior to IFRS adoption, Pengrowth followed the industry's long-established method of full-cost accounting, where the costs in exploration, acquisition and development were accumulated in one country-wide pool of properties and subjected to consolidated depletion and impairment calculations. But IFRS scraps this standard, requiring a more granular capitalization of assets. "We knew there would need to be significant changes to how we had aggregated capital costs," Dashkin says, "and how we had depleted them and tested for impairment." It was a gargantuan task.

If oil and gas first-time adopters, for example, had not been

## "There had been a large amount of work involved with the IFRS transition. It forced us to sharpen the accounting pencil and look at what accounting policy best fits the economic reality"

chair, accounting, operations and information systems (and *CAMagazine's* technical editor for education). "But on the whole, it's quite something that there have been so few confusing muddles in what we've seen in those interim filings and now the year-ends," he says. "Anecdotally, I'm simply not hearing of anything going majorly wrong."

Other than concerns (and complaints) about the volume of explication now required for IFRS compliance, regulators agree that PAEs are adapting to the new standards. Indeed, the OSC was generally satisfied with the results; its 2011 first-quarter critique spoke more to lapses in disclosures than key elements of measurement. Still, the OSC was quick to warn that this side of the equation was crucial to the IFRS process. "What we did, immediately, was to look at all the Q1 filings that came in," says Kelly Gorman, OSC deputy director of corporate finance. "We had set out what our expectations were from transition disclosures well before the formal changeover — a good three-year lead time," she explains. "We wanted issuers to get investors ready for what the differences might look like in the financial statements." It seemed as though many had not gotten the message.

Calgary-based oil and gas producer Pengrowth Energy Corp. looked to avoid such hiccups by diving into IFRS transition as early as spring 2008. Jeff Dashkin, the company's former senior financial analyst and IFRS project co-ordinator (and now staff adviser, accounting research at Cenovus Energy), was determined that Pengrowth conform to what would at times be a rather onerous process. "There certainly had been a large amount of work involved with the IFRS transition," he says. "In some cases, it forced us to sharpen the accounting pencil and take a closer look at what accounting policy fits the economic reality best. In other cases, we expended a lot of resources to comply with IFRS for noncash amounts that were less important to understanding the business."

For Jamal, getting down to the nitty-gritty of a company's

given the option of an exemption from making these detailed, historical retrospective applications, their filings would go from voluminous to volumes. "IFRS has to address the widest possible spectrum of accounting issues across so many uniquely variant industries," says Jamal. "For now, as we get things sorted, the exceptions, exemptions, options and retrospective restatements are going to amass. All I can say is 'happy reading!'"

By its very size and scope of operations, Royal Bank is not likely to prepare quick-read IFRS filings. Like all the banks, RBC has an atypical October fiscal year-end and went live with its first IFRS quarter on January 31. For chief administrative officer and CFO Janice Fukakusa it feels as though they have been functioning in this new environment for years. Operating in 50-plus jurisdictions, RBC has been reconciling its financials in Canadian GAAP, US GAAP and IFRS since 2011. "For us, it was helpful for other issuers to go ahead of us even though they were in different industries," she says. "It allowed the bank to more easily see the potential for market reaction with respect to potential investor acceptance or investor questions."

In the end, says Ron Salole, CICA vice-president, standards, all the banks have performed quite well in their IFRS reporting. "No one is letter perfect, but we're incredibly pleased, given their sheer bulk and the fact that they've had to deal with one or two significant standard changes on the financial instruments side that were sure to affect their systems." Salole points out that less than a decade ago there were no standards at all to help rationalize any number of financial transactions. "Nobody had derivatives or other exotic instruments," he says. "So we're trying with IFRS to catch up with what's happening in the business world — a challenge, to say the least."

RBC's IFRS transition plan was to prepare statements in a way that spoke to stakeholders and analysts in terms of both performance measurement and performance management. "I think in conversion to IFRS, it wasn't just about financial report-

ing and disclosure,” Fukakusa says. “We also had to look at the impact of the change in the accounting base and measurement on our performance management and performance metrics that aren’t necessarily in our financial disclosure because they’re more granular.”

“The issue when you change an accounting standard,” Fukakusa continues, “is, although the numbers change, the actual company hasn’t changed. Earnings may be higher and the balance sheet may be more inflated, but you have the same company year over year. So you need to flag all the differences.”

“In at least one important way, diverting energy and attention to the transition to IFRS during an economic crisis was a good thing,” says John Hughes, a Toronto financial reporting consultant and author of *IFRS Literacy: Understanding the New Financial Statements*. “I think the process forced large PAEs to take a hard look at their baseline principles of measurement, volatility and risk,” Hughes asserts. “Kind of good timing, when framed in terms of a period where stakeholder confidence was a primary concern.” Hughes is currently working with the CICA on an IFRS implementation review to help the CICA understand the impact of the changeover on companies’ financial-reporting cultures and processes. For most of the companies interviewed for the review, the transition was a challenge, but few are reporting major internal systems adjustments as they wrestle with conforming to the new standards. “Everyone seems to be well-versed in the

modifications required and the choices to be made,” says Hughes.

With a set of standards that are now far more open to accounting policy choices based on a company’s best judgments, the task of communicating why and how those decisions were made has become crucial to the effectiveness of implementing IFRS, says Joanne Boyes, senior director, corporate reporting and compliance at Saskatoon’s PotashCorp. “From the start of the transition process back in 2007, we consciously made sure the market understood what the quantitative and qualitative impacts might be as we moved into the 2011 IFRS year,” she says. A perennial all-star at the CICA’s Corporate Reporting Awards, Potash continued on into its 2011 annual filing with a lucid and unambiguous exposition of its accounting changes and subsequent effects on financial statements and business. “In the end, the effects were negligible. But what if they weren’t?” Boyes asks. “How would stakeholders know? We really were striving to prepare IFRS interim reports with a mind-set that this would be new [and it was] to users.” Potash looked to presenting financial statements that leaned more to explaining rather than requiring even well-informed stakeholders and analysts to interpret where changes in the statements reflected the move to IFRS. “So, as requested by the Canadian Securities Administrators, we fully disclosed past years’ comparatives and made sure to isolate any reporting variances related to IFRS.”

For Anthony Scilipoti, CA, CPA, executive vice-president at



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## THE OTHER NEW STANDARDS: ASPE

The key word driving Piston Ring Service's decision to embrace the new set of accounting standards for private enterprises (ASPE) was "user-friendly," says Jeffrey Morton, FCA, CFO of the Winnipeg-based aftermarket auto-parts distribution company. "Thankfully, we didn't have to tackle IFRS," he sighs with relief. "I'm looking for money, and the ASPE model doesn't inhibit the access to capital."

As of January 1, 2011, private companies were given the choice of either joining publicly accountable enterprises (PAE) in their Canadian Accounting Standards Board (AcSB)-mandated transition from existing Canadian standards to international financial reporting standards (IFRS) or adopting ASPE.

Recognizing that the value of financial statements generated from ASPE will find their greatest utility in the hands of lenders and other users, the AcSB created a set of standards that cater more to these users' ability to clearly assess private company liquidity and the ability to service debt. So far, nonpublicly accountable enterprises seem to be more than comfortable with complying with ASPE's streamlined disclosure and measurement requirements.

"And it's not just the lender side of the equation that's been important here," Morton says. "We're a small company and there was concern about the cost in time, manpower and money, if the change in the standards went the other way with voluminous mandatory disclosures." Indeed, what with the introduction of IFRS for public entities (going live simultaneously with ASPE on January 1, 2011), there was a fear that similarly complex and onerously detailed reporting requirements might also be applied to the "privates of the privates," as Morton puts it. "I shudder to think. When I look at what the PAEs have to go through, it seems overwhelming."

For John Barraclough, assistant vice-president, credit at Maxium Financial Services Inc. in Richmond Hill, Ont., the whole point of the transition to ASPE was to create both a reasonable cost/benefit balance for preparers and a lender-friendly set of documents not cluttered with unnecessary disclosures that might muddle the true health and viability of a company seeking financing. "If the lender finds something lacking in the information," he says, "despite it meeting all ASPE guidelines, then it simply gives the customer a call and says, 'I need a bit more disclosure on this,' or 'hey, you've got an odd variance from something from last year; elaborate, please.' It's sure better and more effective than wading through some impenetrable IFRS-like tome."

As a former member of the AcSB's advisory committee on ASPE, Barraclough found that the mix of professionals from the accounting and lending communities was key to creating a set of standards that could operate in the real world. Like the more principles-based IFRS, the lenders agreed with the accounting side's desire for more best-judgment policy choices as companies prepared their financial statements.

The AcSB and CICA, says Barraclough, were able to assure lenders that they had a rigorous set of checks and balances in place to ensure that both the prerequisites and spirit of ASPE's disclosure guidelines would be followed. "With this understanding, we gave the accounting side a sense of what we wanted to see, and, more importantly, how we often attack a set of statements," he says.

"Generally, we first want to determine whether the company is making money, so we migrate to the income statement, looking at performance — scoping out adverse changes, stability, consistency; then we flip back to the balance sheet and take a peek at equity relative to debt; and then, it's a quick zip over to the cash statement to see the source and uses of cash. From there, it's on to the notes. In our world, we call it a 'down 'n dirty,'" Barraclough says. "It's generally a 10- to 15-minute read that gives us a feel for the viability of the company. With the new ASPE, we're able to do just that. Hence, it's been a home run from the preparer's perspective."

When it comes to establishing financial reporting standards for Canadian entities — the mandate of the AcSB — the decision to apply a uniquely made-in-Canada set of standards for private companies means some two million entities will have a choice to make, says Rebecca Villmann, an AcSB principal who for the past seven years has been working on implementing IFRS. "The case that's been made — and it's looking quite successful in the eyes of private companies and their stakeholders — is the creation of a set of standards for them that's reliable, comprehensible and creates a sense of confidence for those who use these financial statements," she says.

"The biggest worry I can think of is with regard to larger private companies who, themselves, may worry about whether to choose to apply IFRS or ASPE. It's not so much in terms of reporting relevance," she explains, "but more with the mind-set that the company would want their financial reports to be comparable with its IFRS competitors."

Unlike Morton — for whom the decision to go with ASPE instead of IFRS was a fairly easy one as it came out of a concern for the users' needs because it was less complex — Tony Chin, CFO of Calgary-based North West Geomatics Ltd., had to give the decision some thought. "Comparability and transparency were considerations," he says.

"Also, I wondered, briefly, about how ASPE might be perceived by potential users overseas were they to ever look at our statements." North West specializes in high-tech aerial digital photography and laser mapping in scores of countries around the world and could potentially seek capital from global markets that use IFRS. "But after a little study, it was clear that IFRS was both unnecessary and too expensive."

If companies such as North West were considering financing from abroad, an IPO or if their competitors were using IFRS, then IFRS could well be the better option. "Having different sets of standards," says Villmann, "is more a case of the AcSB recognizing that one size does not necessarily fit all." — RC



“There was some garbage in those first attempts, but you had to know that it mainly had to do with the mad rush to meet the deadline”

Veritas Investment Research Corp. in Toronto and a member of the Accounting Standards Board, there is little in the new standards that will ensure companies properly disclose all relevant information. “If you had poor disclosure under Canadian GAAP, you will continue that poor disclosure under IFRS, on a relative basis,” he explains. “We’ve raised the bar, but IFRS allows you discretion on what you disclose as well. The fact that IFRS is more principles-based allows for companies — even in the same industry, let alone in countries around the world — to make different judgments in their accounting, which can lead to very different results,” he says. “But, the disclosure rules are quite prescriptive — ‘thou shalt disclose this, this and the other.’ And it is in the quality of these explanations where the rubber hits the road. I can’t analyze and assess what may have improved or worsened in a company without them.”

The OSC’s assessment of the 2011 first-quarter was troubling, to say the least, says Scilipoti. “There was some garbage in those first attempts, but you had to know that it mainly had to do with the mad rush to meet the deadline and confusion over a set of standards that are still evolving.” Indeed, the standard-setters

and industry associations are hard at work on such moving targets as revenue recognition, leasing, fair value, consolidations and joint ventures, etc. Perhaps the most universal of complaints heard in the CICA review is companies’ complaints that the process of creating the new standards is not complete.

“What’s echoing from most of these issuers is a strong sensation of IFRS fatigue,” says Hughes. “Accounting for one’s activities is very much a part of business, but they want to get back to business, nonetheless.”

Jamal counsels patience. “There’s been all kinds of errors, lapses and fuddles in a process that has also produced superb results. Hopefully, in a couple of years enough bottoms will be slapped and ears twisted and everyone will be sorted out in this new system,” he laughs. “We just have to keep reminding ourselves that the problem in accounting is that it was not created to [and will never account for] the ‘average.’” Procrastination, compromise and conciliation are the costs of change. Account for that, if you’re going to do anything.

Robert Colapinto is a freelance writer in Toronto



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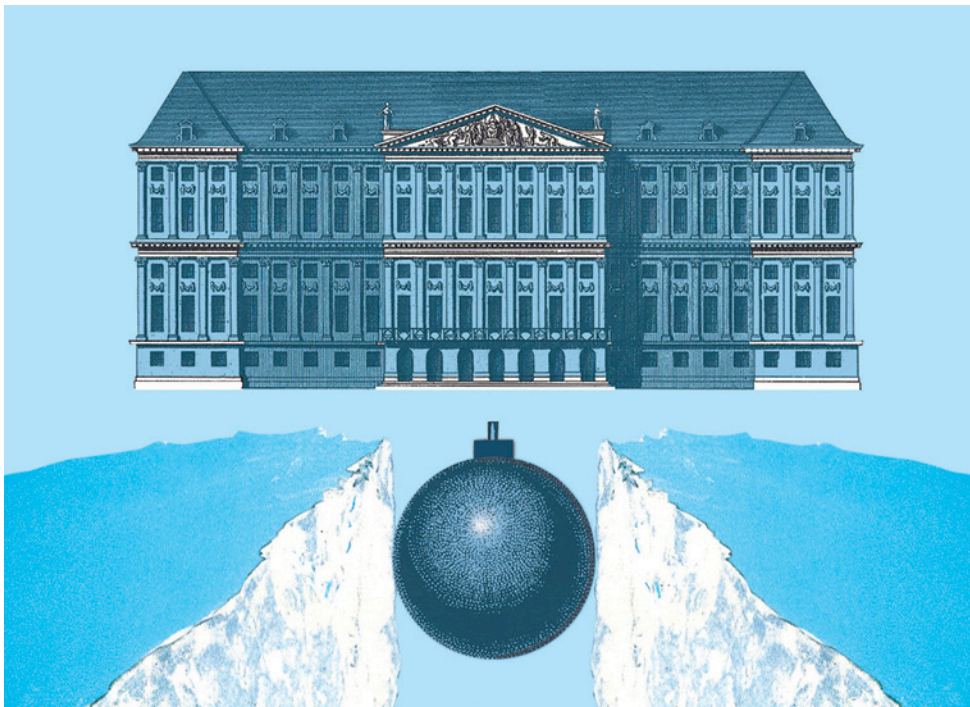
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## The ticking time bomb

An estate-freeze strategy can be useful, but should be done as part of an overall plan reflecting the family's objectives



**M**inimizing taxes is a goal for most entrepreneurs. And an estate freeze can be a good strategy to manage the income tax burden that comes with having built a successful, valuable business.

However, when a freeze transaction is done without being part of an overall plan for the family and the business, it can leave the family with much unfinished business. By its nature, the estate freeze results in changes in the ownership of the family business — what is owned and by whom. And these changes open up new considerations for the family that are often overlooked. In addition, although the estate freeze caps a potential tax liability for the business owner, if the eventual payment of that tax is not planned for, it can leave the family with a ticking time bomb.

An estate freeze typically involves exchanging property that can grow in value for property that has a fixed

value. (Thus the term “freeze.”) For the successful business owner, this often involves exchanging (on a tax deferred basis) common, or growth, shares in the business for preference shares having a value fixed at the value of the business at that time. New common shares are then issued to the successors (e.g. family members) either directly or via a family trust. The new common shares can be issued for nominal value, since at that point the value of the business is reflected in the freeze shares. Thus, the older generation has not given up the value it had, it has just been frozen. And through the new ownership structure, future growth can accrue to the next generation.

To avoid creating problems for the family down the road, the freeze should be part of a comprehensive plan for the family and the business. First, a detailed picture of the family's business interests, financial affairs and circumstances should be developed. This includes identifying the family's goals and objectives (besides saving tax) relating to the business, its wealth and the family.

The goals and objectives of the older generation may not be the same as the successors' and it may be best to discover this early on. It is not uncommon to see cases where members of the younger generation are not aware of the transaction and years later learn they are beneficiaries of a trust that owns shares of the family business. This can be a recipe for problems when that sense of entitlement kicks in and the successors exercise their rights as shareholders. Without taking the time to uncover what the family wants to accomplish, they can struggle to understand how the freeze transaction fits into the grand scheme of their business and financial lives or what it really means for them.

Another important step is determining whether the older generation can afford a freeze. There are many examples of freeze transactions having been implemented with the older generation finding out years later that not only did it cap its tax liability, it also capped the growth of its wealth. Now the parents don't have enough and have to look to the kids to share. As part of a comprehensive plan there should be an accompanying financial plan that identifies the lifestyle needs of the older generation and the resources needed to support that lifestyle, now and in the future. A key question is whether members of that generation have accumulated enough capital to allow them to do what they want for themselves, their family and their community. If the answer is no or maybe, then a partial freeze, or gel, should be considered. It is possible to structure the transaction so the older generation still has the potential to share in the future growth should circumstances change, in which case it is more of a gel than a freeze. For example, the older generation could be beneficiaries of a family trust that is established to receive the new common shares.

In addition to identifying the income needs of the older generation, the financial plan should address the source and type of future income, taking into account tax efficiency and the suitability of the sources. For most business owners, the business has been their major (and perhaps only) source of income. They control their business and simply treat it as their cash source. At the end of the year, journal entries and tax filings are made to reflect the draws taken. Thus a key question is how the freeze transaction will affect their ability to receive income from the business. Will they receive dividends on their freeze shares and in what circumstances and what amount? Will they continue to be entitled to a salary? Will the new co-owners (i.e. their children and their spouses) have a say in what income they can take? These are important questions that if unanswered can leave the older generation feeling financially insecure.

The lack of a succession plan for the business can be another major oversight in an estate freeze. The estate freeze involves family members becoming owners of the business, either directly or as beneficiaries of a family trust, and has the potential to change the landscape for the family. But an estate freeze by itself is not a succession plan. The family still needs to address whether and how the new owners will be involved in the management and

operation of the business. In fact, changes to ownership should reflect who is going to be involved in the business, thus reflecting the family's goals and objectives in that regard. (Rather than all children, including inactive ones, becoming shareholders or beneficiaries of the trust, other arrangements might be more suitable.) And what happens if the new owners' involvement does not work out, or they die, or they have marriage problems? What are the new shareholders' rights and responsibilities as owners? Is the older generation still involved in the operation and management of the business and what is the transition plan for it? Does it still control the business and the corporation? Answers to these questions will go a long way to helping the family put together a business transition plan in conjunction with the freeze.

Another important part of the overall plan is the integration of the freeze transaction with a well-thought-out estate plan. Often the estate plan is incomplete or does not adequately reflect the changes that have been made to the ownership. It may also not deal with the critical question of what happens to the business (and the freeze shares) if the older generation dies or becomes disabled. It is not uncommon to see wills that provide for the generic division of the estate among all the children,

### **If the estate plan leaves the shares to certain children, who will pay the tax on those shares? The freeze only caps the tax liability; it does not eliminate it**

without specific attention as to who should receive the business interests. Do parents really intend to leave their shares to all the children, even though they are not all involved in the business? What is that going to mean for the children who are involved? Do they have to buy out their siblings and how will they do it? A more appropriate solution for the family can be to carefully analyze the assets in the estate and use other nonbusiness assets or life insurance to equalize things for the other children.

If the estate plan leaves the shares to some, but not all, of the children, who will pay the tax on those shares? The freeze only caps the tax liability; it does not eliminate it. If this question is not addressed it means that in effect all the residual beneficiaries of the estate, including the nonbusiness children, bear the tax. This can be seen as unfair and may not be what is intended. This is where life insurance can play a significant role.

If a family trust is put in place to own the common shares of the business corporation, the plan should address what happens to that trust and the shares it owns in the future or when the older generation dies. In many cases the terms of the trust may leave this to the discretion of the trustees, with no guidance given. In other cases, the trust simply provides that on the wind up of the trust the shares get distributed equally to all the children, active or not in the business. Sometimes the trust will contain specific terms about who gets the shares and when (thus providing a significant link between the freeze transaction and the estate plan).

Other trusts may contain a power of appointment, which allows the person with that power to indicate through another

instrument (including the will) who is to receive the shares upon the winding up of the trust. There are a number of options but the bottom line is, as part of the overall plan, what is to happen to the trust and the shares it owns needs to be addressed.

A shareholders' agreement can be a key component of the succession plan and the estate plan. Often it is thought that shareholders' agreements are not needed for family-held businesses. However, another way of looking at this is that this is where you need one most because family dynamics can really complicate things. Such an agreement would include a death buy-sell arrangement — not only for the older generation but also for successors who now own an interest in the business.

And what about that other ticking time bomb — taxes? As mentioned, the freeze itself only caps the tax liability for the business owner, but does not eliminate it. Often there is no plan for how tax will be paid and what resources will be available for that. Leaving the family with no plan for how tax is going to be paid or minimized is akin to making a huge financial commitment without knowing how you are going to pay for it. It can cause financial stress, resulting in pressure decisions to sell assets and creating disputes among family members.

As a result of fixing or freezing the value, the amount of tax payable on those shares some day — either if they are sold or if the person dies owning them — can be estimated. For many business owners this is a large number. After all, they started with very little, have little cost base attached to their shares, yet have built a successful and valuable business. Thus notwithstanding the freeze, their potential capital gain and tax payable is significant.

With this issue, an initial consideration is whether there are steps to be taken to reduce that tax exposure. For example, the capital gains exemption may be available to family members that would shelter tax on capital gains from the shares. Consider whether the shares qualify today, and should steps be taken to use the capital gains exemption to increase the cost base of the shares. This may be important if it is possible that in the future the shares will not qualify. This is key planning for retirement and sale or on death. It is increasingly common to see

situations where business assets were sold by the corporation but the older generation continued to own the corporation, and the corporation invests the proceeds in real estate and other passive assets. Of course, at that point it is too late to use the capital gains exemption and reduce their tax since the shares no longer qualify for the exemption.

Examine what other assets would be available to pay the tax and assess the liquidity of the family's resources. Often the majority of assets are tied up in the business. This is where life insurance can play a role and help solve a significant problem. It can provide liquidity to pay tax and it can enhance the estate and be used for equalization for family members not involved in the business. In addition, corporate-owned life insurance can reduce the overall payable tax. The life insurance proceeds themselves provide the liquidity to pay the tax, thus avoiding the need to sell corporate assets and avoid triggering further tax. The credit to the capital dividend account from the receipt of tax-free life insurance proceeds can be used to reduce the extraction tax payable by the estate and/or beneficiaries. Thus, not examining the use of insurance in the overall plan and providing the family with information to make an informed

## Leaving the family with no plan for how tax is going to be paid is akin to making a huge financial commitment without knowing how you are going to pay for it

decision about its choices would be a significant oversight.

Take Andy and Sue's similar predicament. They had seen the seeds of conflict among their three children and did not want that to grow into anything further. The couple, in their late 60s, has been married 40-plus years and in business all that time. Over the years they built up significant assets: they own a corporation that has significant real estate and other investments. That holding corporation also owns a second corporation that owns their remaining operating business. They were concerned about the taxes payable in their estates some day. They were aware that as their business interests grew in value, so would their potential tax bill.

Also, with one daughter managing the business for the past 10 years and the other two not involved, they were anxious to pass ownership to her. They thought they had a plan under which they would transfer the business to her on their death. Their wills directed that after they both die, the shares of the corporation that owned the business would be transferred to her. What hadn't been thought through was that they did not own the operating business shares directly. The shares would have to be transferred by the holding corporation, not by their personal estates. This would

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have resulted in double taxation. Income tax would have been payable on the value of the business on their death (as a result of the deemed disposition on death of the shares that they owned, which included the value of the business). And income tax would have been payable again when the shares were transferred by the holding company to their daughter (since it would be a transfer between related parties and deemed to occur at fair-market value). Compounding the problem was that the tax would be borne by the estate, impacting the value left to the two other children.

The financial plan prepared as part of their comprehensive wealth plan revealed that they could afford to do a freeze. Thus a corporate reorganization and an estate freeze were implemented. This resulted in their directly owning the operating business, so they could deal with it in their estate plan. Also, the freeze capped their tax liability; however they also wanted to know how the tax could be paid without creating problems for their children or conflict in the family. There were a few options for them to consider. With having the complete financial picture, it was possible to assess the other resources they had and the liquidity of those assets. It was determined that their real estate holdings were not that liquid and they would not want a fire sale situation to pay taxes. They also did not want to force a sale of the business to pay tax. A sinking fund was considered — that is putting away funds each year that would be available to pay the tax (if they lived long enough). They also looked at life insurance. In the end they decided upon a joint and last-to-die permanent life insurance policy owned by their holding corporation. It could be funded using the lower taxed cash resources in the holding corporation, without impacting their lifestyle. In addition to providing liquidity, the life insurance and the capital dividend account that it will create in the corporation will allow them to significantly reduce the overall tax burden for the family.

Of course, an important component of Andy and Sue's estate plan is a shareholders' agreement that spells out how the life insurance proceeds are to be used to redeem shares when the second of them dies. They will pass the business on to their daughter, while preserving their estate. This will also allow them to treat the other two children fairly and minimize the potential for conflict down the road.

While the estate freeze can be a very useful strategy to manage the tax burden,

it is important that it be done as part of an overall plan that not only reflects the family's goals and objectives but also addresses the many issues and necessary components. It should be an opportunity that does not create more problems for the family than it solves.

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## Reviewing rotation

Is mandatory rotation of audit firms the answer to promote independence and to improve audit quality?

**A**uditor independence, objectivity and skepticism are necessary for proper functioning of capital markets. In the hope of achieving this ideal of auditor independence, regulatory agencies in the EU and the US proposed mandatory rotation of audit firms through exposure drafts issued in mid-2011. Potential effects of the procedures used to select and appoint auditors have long been of concern with respect to real and perceived independence and objectivity of auditors (e.g., Mautz and Sharaf 1961). Enhancing perceived and actual auditor independence is a worthy objective for public policy. However, academic research and practical experience suggest that attempts to achieve this increased independence through mandated rotation of audit firms is likely to have other unintended and undesirable consequences. It would be prudent for public policy to consider the balance between all consequences of the proposed auditor rotation.

The quality of audit is determined by auditor indepen-

dence and also by many other factors, including quality of accounting standards, accounting education, auditor expertise, audit committees, corporate governance, auditor discipline, liability and a host of institutional features of the audit environment. Attempts to promote some of these desirable attributes of audit often degrade others, making a perfect audit an unattainable dream. Public policy, therefore, should aim for the best audit quality and not fixate on any subset of the determinants of audit quality. Existing research leads us to conclude that, in spite of its obvious appeal, mandating audit firm rotation would be a bad policy. Such a change may impair auditor independence, weaken audit expertise and undermine corporate governance.

### Rotation and auditor objectivity

The proposal to mandate auditor rotation is based on the belief that it promotes objectivity because new personnel (or audit firms) are not tied down by judgments, compromises and past relationships. A new auditor brings a fresh set of eyes and has the opportunity to raise issues that in the



past have been overlooked or settled. Consistent with this view, academic research shows that new auditors are better able to identify issues, alter their judgments and bring issues up for discussion when they are not personally committed to prior decisions (see Tan, p. 113-35 in Spring 1995 issue of *Journal of Accounting Research*). While a fresh look at issues that might have been overlooked by the existing auditor, or settled improperly in favour of the client, supports rotation, mandated rotation also creates the possibility of some important issues being overlooked by new auditors or settled improperly in favour of the client. Besides, there are other features of the audit market that might undermine the potential advantages of auditor rotation.

A recent academic research study by Fiolleau et al. (2010) shows that although regulations require auditors to be appointed by the audit committee of the board of directors of the client company, the management plays a significant role in the process and may even dominate it. A mandate for audit-firm rotation will force the incumbent and potential auditors into a beauty contest, or bidding war, every few years. The market power of audit firms is so much weaker than the power of their clients that at the time of bidding for engagement the former compete among themselves to convince management and the audit committee of their potential clients of their commitment, service, cultural fit and responsiveness. In this environment, each hiring exercise becomes an opportunity for opinion shopping by clients, lowballing of audit fees and demonstrations of loyalty and solicitous relationship-building by the auditors. Many auditor behaviours that the proposed rotation mandate is intended to discourage get exacerbated when the audit firm enters into a beauty contest to get an audit engagement.

While there is enough competition among auditors that auditor rotation is likely to produce beauty contests, it is questionable if there is enough competition to allow for a true fresh look. Fiolleau et al. (2010) report their observations on the consequence of the audit market being concentrated in the hands of just four large international firms. Most large clients already receive one service or another from every one of the four firms. If one of these accounting firms audits the client, the other three often provide it a host of advisory services in tax, valuations, etc. The perpetual engagement and pre-existing relationships between most large companies and all four major audit firms implies there is only limited opportunity for mandatory rotation to bring about a fresh look. The US General Accounting Office (2003) study on mandatory audit firm rotation estimated increased initial audit costs of more than 20% (some studies in Europe suggest 40%), which did not include costs incurred by the audit committee and management to conduct the tendering process.

Finally, noting that familiarity arises between individuals (e.g., the audit partner and the CFO), not firms, a large part of the benefits of taking a fresh look may be obtained by rotating the partner and/or other senior personnel on the audit team. Since the policy of partner rotation is already in place, audit-firm rotation is unlikely to add any significant marginal benefit, especially when the considerable costs of firm rotation are taken into account.

Thus regulatory proposals to mandate audit-firm rotation are likely to yield little by way of benefits and incur the additional harm associated with increased frequency of beauty contests, which undermine auditor independence.

#### **Rotation and auditor expertise**

There is compelling evidence in academic research that audit-firm rotation will impair auditor expertise. The Public Company Accounting Oversight Board's (PCAOB) concept paper indicates awareness that the auditor is most vulnerable to missing fraud in a new engagement (see also St. Pierre and Anderson, p. 242-63, Vol. 59(2), 1984, *The Accounting Review*). Other studies (e.g., Myers et al., p. 779-799, Vol. 78, July 2003, *The Accounting Review*) show that the quality of accounting numbers is associated with increases in auditor tenure. The most compelling force associated with accounting accruals is auditor industry expertise (Craswell et al., p. 297-322, December 1995, *Journal of Accounting and Economics*). Collectively, this suggests that a policy of mandatory auditor rotation could undermine accretion of expertise and impair audit quality.

The thrust of generally accepted accounting principles (GAAP) is increasingly oriented to having management communicate to

**There is enough competition among auditors that auditor rotation is likely to produce “beauty contests,” but is there enough competition to allow for a true “fresh look?”**

investors how they operate the business. Auditors' understanding of the substance of client business would be undermined if they are rotated every few years. The Fiolleau et al (2010) study reveals that even the four largest audit firms lack depth of expertise in serving large corporate clients across all industries outside main business centres such as Toronto, Montreal, Calgary and Vancouver. For clients with headquarters in smaller cities, finding industry specialists in local offices can be a significant challenge.

#### **Improving audit quality**

Audit quality is not just an attribute of the auditor alone. The nature of GAAP is also a major determinant of audit quality. Over recent decades, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) have set standards that de-emphasize verifiability in favour of the market-to-market valuation, no matter how illiquid the market may be. It has also adopted a practice of writing detailed standards in its attempt to close loopholes, but ends up creating new ones. For example, exploitation of the special purpose entity rule by Enron a decade ago and of the Repo 105 rules by financial-services firms during the recent crisis illustrate how detailed rule writing leads to improper reporting. This type of standards place auditors in a difficult position vis-à-vis corporate management. The shift in GAAP toward the so-called “fair-value accounting” is a major factor undermining audit quality. Auditor rotation is not likely to help improve audit quality when the underlying accounting quality is questionable. On the contrary, it will simply create more opportu-

nities for determined clients to conduct opinion shopping without having to fire their auditors.

#### Importance of audit resignation as a signal

When the financial press report that company X, audited by firm Y for the past 20 years, has changed its auditor, investors get an informative warning signal that draws scrutiny by the investment and regulatory communities. PCAOB's mandatory rotation proposal will routinize and therefore reduce the saliency of this important signal. Less attention and scrutiny given to such signals will undermine the quality of audit.

#### Transfer of audit resources from verification to marketing

The mandate for audit-firm rotation will induce audit firms to shift more resources to marketing themselves to potential clients. These resources can only come from cutting back on the substantive work of verification during the course of their audits or by raising audit fees. Individuals in the audit firm will find their presentation and marketing skills becoming more valuable relative to their technical accounting and auditing skills.

#### Confusion from too many initiatives

Auditors work in a complex economic and social environment. There are economic incentives to be responsive to management but these have to be balanced with incentives emanating from

audit committees, concurring review partners, national office reviews, litigation, GAAP and industry practice, and PCAOB/Canadian Public Accountability Board reviews. In some countries two audit firms jointly conduct an audit, making it difficult for any single audit firm to have consistency in its audits across countries as complex coordination is required across audit firms. Fraud cases such as Parmalat went undetected due to a lack of continuity of the auditor and presence of multiple audit firms. Adding more agents and incentives into this mix serves to further complicate incentive structures, and could create interpersonal friction and potential for unintended consequences as accountability and authority get dispersed across a variety of agents. This increases moral hazard and the potential for confusion. Adding one more mandate of audit-firm rotation is likely to add to the confusion.

#### Conclusion

Audit-firm rotation is a poor instrument to promote independence, especially in an environment where auditors are appointed by board audit committees with participation of management. The potential benefits of rotation seem likely to be exceeded by the harm associated with the beauty contest during the auditor-hiring process. Rotation actually impairs audit quality by enabling more frequent opinion shopping and lowballing. Rotation also discourages accretion of audit expertise, downgrades the valuable signal of auditor change, and shifts even more resources from substantive

verification and tests to marketing of audit services. Most of the benefits of rotation can be realized by rotating the engagement partners. Given the limited independence of most audit committees from the management, improving audit quality through firm rotation may simply not be possible. A more fruitful approach is for the FASB/IASB to rethink their approach to writing standards of financial reporting, so as to enhance the verifiability of financial reports and improve accounting and audit quality.

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## Pray and prey, more than homonyms

Community and religious group members often find themselves victims of affinity fraud and should beware of the too-good-to-be-true pitch



All fraud is despicable but one type seems especially heinous. And that is affinity fraud, which refers to a scam perpetrated upon members of a common group, often within religious or ethnic communities. Sadly, there is no shortage of examples of such frauds.

One prominent case involved Prosporex Investment Club Inc., which victimized 1,700 people, of which a significant number were members of Toronto's Caribbean community. Many of the victims learned of the investment opportunity through their church or through friends in their community. The scam garnered the perpetrators more than \$29 million, of which only \$5.3 million was returned to investors, according to a decision released by an Ontario Securities Commission panel in October 2011. The OSC panel found that Prosporex had breached the

Ontario Securities Act and "acted contrary to the public interest by engaging in fraudulent conduct, unregistered trading, and an illegal distribution of securities."

Starting in 2007, Prosporex recruiters promised investors returns of up to 20% a month, which the company said would result from pooling investors' money that would be invested by professional traders in foreign exchange markets. Paul Edwards, pastor of Ekklesia Kingdom Ministries in Toronto, told CTV's *W5* that he and his wife gave Prosporex \$15,000 after a member of his flock promised their money would double within a year of getting in on this opportunity.

Pastor Edwards and his wife didn't have extra cash to invest, so Prosporex arranged for them to obtain a loan from AGF Trust Co., a respected financial institution. A number of investors did the same, all with AGF. Within a year Edwards logged into a password-protected website to find that the promise of spectacular returns had come

true. Pastor Edwards' initial \$10,000 had grown to \$18,500 and his wife's \$5,000 was now worth \$8,500. That good news spread rapidly within the church and the community.

But by 2009, the news turned sour. The OSC began investigating Prosporex and in a 2010 report concluded that the company's principals had "utilized multi-level, or pyramid, marketing techniques whereby investors were compensated to recruit others." Panicked investors tried to get their money back, but it was too late. The bulk of the \$29 million was gone. To make matters worse, AGF insisted the loans had to be honoured, asserting it had no idea anything untoward had taken place. Maura Fowler, a mother of three, lost \$7,500 in the scam, a sum she had borrowed from AGF. She told *W5* that what Prosporex had done to her felt like "financial rape."

In March 2012 the OSC imposed sanctions, including permanent prohibitions on securities trading and substantial fines on the correspondents in the scam.

The Prosporex case, like most affinity frauds, preyed on human vulnerabilities. Central to the effectiveness of affinity scams is the sense that those in a close-knit community, one with strong common bonds, would never violate that trust. This belief is likely heightened when the community is a religious one, where everyone is seen as following the same spiritual path. An additional factor is that many affinity victims, especially those in a religious group, are seniors and more prone to trusting a pitch from someone within their faith. "Who would steal from a church?" is just a short step from "Who would steal from a fellow church member?"

Unfortunately, some unscrupulous souls are all too willing to do just that. Enough so that the British Columbia Securities Commission (BCSC) supported an initiative called God's Fraud Squad to alert the province's religious groups to affinity schemes.

The genesis of the idea, so to speak, originated with Seamus Mackrell, a Catholic priest in Chilliwack, BC. He was working as a spiritual caretaker at Chilliwack General Hospital in 2003, he told the *Globe and Mail*, when he noticed a number of people from the Fraser Valley area, regarded as BC's Bible Belt, were coming in with depression and all sorts of stress-related injuries. "When I'd sit down with them, I'd find out that it was all because of fraud."

Not far away, Presbyterian minister John Haycock, who also worked at a hospital, observed a similar pattern. "When the priest and the minister compared notes, they were struck by what they saw," the *Globe* reported. "The wave of religious con victims coincided with a rise in what securities commissions throughout North America consider one of the most serious scam threats facing investors: affinity fraud." Together they formed God's Fraud Squad.

Since 2003, it has spread the word to churches in BC. To carry out their work, the reverends have been financed by the BCSC with monies from fines and penalties it levies. "British Columbia has thousands of churches and dozens of different congregations in many different languages," a BCSC statement notes. "The BCSC aims to ... stop faith-based scams in progress. Our goal is

to make sure that leaders and members of BC faith communities know the BCSC's role in protecting investors, and how to report investment fraud if it happens to them."

And it certainly does happen. "From 1995 to 1997, Gary Stanhiser, a man posing as an ex-pastor and investment adviser, sucked \$11 million from 300 investors in the Fraser Valley's Seventh Day Adventist community," according to the *Globe*. "Between 2001 and 2005, another con man selling fake securities cheated the Fraser Valley's Mennonite community out of about \$3.5 million. Most often, the scammers employ Ponzi, or pyramid, schemes in which money from new investors is used to pay earlier investors. The last to join generally lose the most."

But it's not only churchgoers who are targets of affinity fraudsters. Ethnic groups are also susceptible. One of the largest individual frauds in Canadian history was an affinity scheme perpetrated on the Ismaili community in Canada and worldwide. It began about a dozen years ago when Salim Damji, who claimed to be a dentist, told members of the Toronto Ismaili community about a can't-miss opportunity.

He let it be known a company he owned, Strategic Trading Systems (STS), held the rights to a tooth-whitening product

## **Central to the effectiveness of affinity scams is the sense that those in a close-knit community, one with strong common bonds, would never violate that trust**

known as Instant White, which he was about to sell to Colgate Palmolive Corp. Before this happened, however, he wanted to offer his community members a chance to invest in STS. The premise was that once the deal was finalized, STS would skyrocket in value. According to Damji, investors would recoup \$20 for every dollar they put in, a 2,000% bonanza. Over a two-year period approximately 5,000 Ismailis worldwide took the bait, to the tune of \$78 million.

Unfortunately, Damji's story was pure fiction. Incredibly, he had concocted the scheme after watching the product sold on The Shopping Channel.

In April 2002, some time after Colgate and the OSC became aware of Damji's claims, he was arrested and sentenced to six years and three months in prison. By that time, however, most of the money was gone and never recovered.

No matter how much people are warned about affinity scams, some perpetrators are so trusted it's hard to fathom anyone would doubt their sincerity. Perhaps the most blatant example of this vulnerability is Ephren Taylor, known as the black Bernie Madoff.

A charismatic speaker, Taylor had a most impressive résumé. According to a 2011 Associated Press report, at 12 he sold video games he designed and by 18, he and a friend created a job-search engine that he claimed was valued at more than US\$3 million. (However, a subsequent lawsuit questioned that figure.) In 2006 he was tapped as the CEO of City Capital, now based in California, and he was quick to boast in interviews that the move made him the youngest black leader of a publicly traded company in the US.

An author of books about his financial expertise, Taylor was a frequent guest on TV programs, where he served up investment advice. He even landed a spot speaking to a youth leaders summit at the 2008 Democratic National Convention, AP said. And rapper Snoop Dogg chose him to manage a charitable endowment.

Taylor especially targeted audiences at African-American churches with a list of his impressive accomplishments and an uncanny business sense. He called his presentations Wealth Tour Live.

“He had the blessing of top clergy as he gave financial seminars from the pulpit on Sundays, promising rock-solid investments — only many of the churchgoers said they haven’t seen a dime,” *The Economist* reported this year. “Two lawsuits filed [January 2012] claim the 29-year-old Taylor was a con artist who targeted worshippers throughout at least five states on the East Coast since 2004, swindling tens of millions of dollars in a Ponzi scheme.”

His pitch was a classic affinity con. “He knew if he went to a Christian African-American and said, ‘I can take your hard-earned investment money, and you’re going to earn more money, but more importantly you’re going to do good for your church and community,’ that they would fall for it hook, line and sinker,” said Cathy Lerman, an attorney suing Taylor in North Carolina on behalf of victims. “He was a master of creating a marketing presence. He would say: ‘If you want to check me out, just Google me.’” He had no problem convincing people he was an ordained minister, even though he had no formal seminary training, according to court documents.

It is easy to see why so many church members, and their friends, believed in Taylor and eagerly gave him money to invest.

In late 2009, for example, Eddie Long, pastor of the 25,000-member New Birth Missionary Baptist Church in Atlanta, introduced Taylor at one event with the words: “[God] wants you to be a mover and shaker ... to finance you well to do His will,” *The Economist* reported. “Taylor offered ‘low-risk investment with high performances,’ chosen with guidance from God.”

Most of the congregation jumped at the opportunity to make the 20% guaranteed returns Taylor promised, to the tune of about US\$1-million worth of investments collectively. Of note is that Long has been named as a codefendant in a suit against Taylor. Long also recently settled, for US\$15 million to US\$25 million, claims that he had inappropriate sexual relationships with young men.

Several lawsuits have been launched against Taylor, who has since disappeared. It has been reported that he is under investigation for a number of criminal offences but, at the time of writing, no charges had been laid.

Although affinity fraud can occur anywhere, it is more common in certain areas.

While BC is likely the affinity fraud capital of Canada, Utah, which is 60% Mormon, has that dubious honour in the US.

In 2010, regulators and the FBI were investigating cases there with 4,400 victims and perhaps US\$1.4 billion (or US\$500 for every Utahn) in losses, according to *The Economist*. “The numbers have surely climbed since, with the three largest cases alone involving combined losses of up to US\$700 million, says one investigator. Mormons tend to be both trusting and welcoming of newcomers, says Keith Woodwell, head of Utah’s Division of Securities. As soon as you pull up to your new house, neighbours appear to help you unpack. A scammer who gets his foot in the door can exploit this closeness.”

How can people protect themselves? It can be difficult but financial advisers, such as accountants, can play a critical role.

Make sure clients always check out any individual they plan to invest with. Taylor, it seems, had a criminal record for fraud earlier in his career.

Remind clients that the too-good-to-be-true maxim is sound advice and not just a cliché. Warn them of the age-old gim-

## **Fraud can occur anywhere, but it is more common in certain areas. BC is the affinity fraud capital of Canada; Utah has that dubious honour in the US**

mick of fraudsters pressuring victims into investing quickly, before a deal is no longer available. Underline the need to have every aspect of the opportunity clearly spelled out in writing. Fraudsters prefer not to do this; legitimate investment experts understand why this is the correct thing to do.

Despite this advice, many potential victims believe a seemingly devout and good person would never defraud them. Keep a file of affinity fraud examples and show them to clients. And remind them that pray and prey are sometimes more than just homonyms.

David Malamed, CA·IFA, CPA, CFF, CFE, CFI, is a partner in forensic accounting at Grant Thornton LLP in Toronto. He is also *CAMagazine*’s technical editor for Fraud



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## Assuring success

Adding a financial project controller to your team might just be the key to a well-managed large project

**S**tudies and reviews of many major projects in the construction and software engineering industries have revealed a new trend emerging in large-scale project management. In line with best practices, this trend favours the involvement of a financial project controller (FPC) on the project team.

This trend is intended to strengthen the project governance model by involving an FPC on the project team. It is supported by recent studies on the delivery of major projects (Standish Group, NIST, PMI) that show that many projects qualified as successes have had less than satisfactory outcomes, most often leaving managers' expectations unmet.

Understandably, no study can provide conclusive findings that are accepted by the community of project management experts due to differences in survey methodologies and rating scales used from one study to another; amounts that are relatively significant allocated to project contingency for unforeseeable circumstances or events; and qualitative elements specific to each study. On the one hand, however, there is agreement that the project success rate ranges from 25% to 35%. Success depends on completing projects on time, on budget and on deliverables being produced in accordance with the calls for tender or needs analysis.

On the other hand, our experience shows that almost 20% of projects will be viewed as largely successful by all stakeholders; and close to 15% experience major overruns, potentially leading to their cancellation.

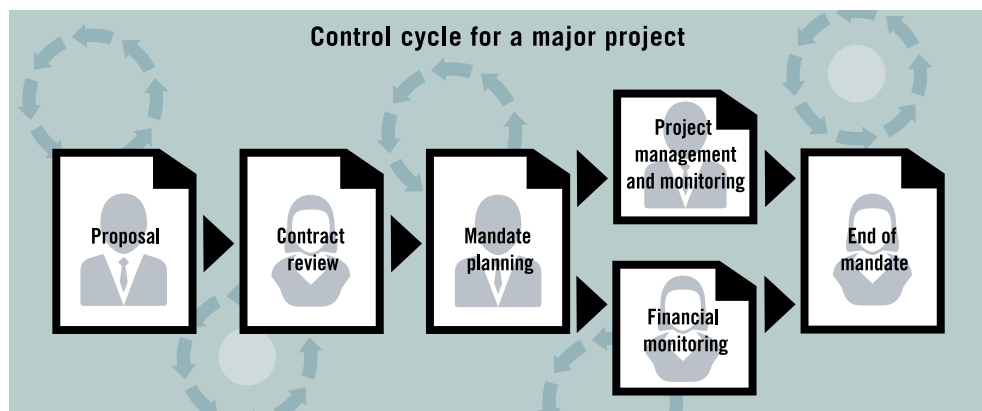
The main reasons major projects fail to be completed and delivered include poor planning and control of costs and timing; difficulty in determining the project's scope; weakness in the accountability process; and poorly defined roles.

The approaches, methods and teachings of good practices in project management date back to the Second World War, when engineering faculties began teaching best practices as part of the introduction to operational research and management sciences. However, during the 1970s, project governance experienced real growth following the creation of the Project Management Institute (PMI) in 1969. PMI issues numerous standards to describe, support and establish good practices that facilitate efficient project planning and management. The best practices favoured by PMI include:

- creating a project office;
- clarifying roles and responsibilities;
- naming a project sponsor responsible for decision-making;
- reducing the number of validation levels;
- establishing an accountability model;
- selecting a project manager;
- establishing a project monitoring committee; and
- involving an FPC.

The following sections will explain the FPC's position, roles and responsibilities in major project teams. An innovative key to success is to involve an FPC, whose participation is increasingly sought after by organizations that are very committed to good project governance.

The FPC is a key participant, ensuring that financial issues are clearly identified and promptly communicated to



## Mandate planning

Main project control activities	Responsibilities	
Updating risks	Project manager Control project officer Financial project controller	Responsible Participates Reviews
Completing a detailed project plan (resource allocation, timing, batches, task scheduling) and the budget supporting the plan	Project manager Control project officer Financial project controller	Responsible Participates Reviews
Establishing management and performance indicators: KPI, IPD, quality, risk level, challenges	Project manager Control project officer Financial project controller	Responsible Participates Reviews
Preparing the cash-flow statement	Project manager Control project officer Financial project controller Treasury dept.	Participates N/A Reviews Responsible
Devising the communication plan (committees, meetings, status, etc.)	Project manager Control project officer Financial project controller	Responsible Participates Reviews
Devising the quality plan	Project manager Control project officer Financial project controller	Responsible Participates Reviews

the appropriate authorities. The FPC supports the project manager and ensures policies and procedures, internal controls, tools and other documents are properly used and comply with the company's standards and procedures. The FPC plays a leadership role as regards the accuracy and completeness of the reporting on a given project. Unlike the control project officer, who reports to the project manager, the FPC reports to the company's finance department and is therefore independent of the project team, which reinforces his or her position as gatekeeper and observer for smooth project execution.

The FPC participates in all phases of a major project's control cycle, as illustrated on p. 42.

The key participants in project monitoring and control are the project manager, the control project officer and the FPC. The nature of the positions held by these three project participants often results in inefficiencies, such as duplication and redundancy of work.

The proposed model helps clearly identify each participant's management, monitoring and control tasks in relation to the four major control areas — costs, timing, scope and quality. The model actually reduces the risk of duplication and redundancies.

For example, the table above details the main project control activities of the mandate-planning phase. It shows the division of roles that will enhance the task assignment model's performance.

Control activities reinforced by FPC involvement result in effective mechanisms that are essential to project success. The FPC and control project officer also assist the project manager in implementing tools, processes and rigorous monitoring mechanisms for sound risk management.

The FPC's contribution will free the project manager from nu-

merous routine administrative tasks, allowing the project manager to spend more time on strategic elements (meetings with management, supplier management, risk management and control) and tactical elements (team and resource management, activity planning, workshop creation, recovery plan development, etc.).

Some benefits of involving an FPC include early detection of risk areas; prevention of problems identified in the early stage; detailed analysis of project costs; independent assessment of the extent of issues and challenges observed; reporting and effective communication with stakeholders; increase in the organization's responsiveness (reduced scope, arbitration, project shutdown, etc.); establishment of adequate recovery plans; and more effective and efficient use of human and material resources.

This approach provides leverage for increasing the productivity and synergy of the team and the stakeholders associated with the project's completion. Furthermore, it enhances the value of the project manager's undertaking, while giving the FPC a right to oversee and control the budgets and expenses incurred. This approach also increases the accountability of the resources responsible for the project's smooth running in terms of cost, monitoring and performance. Lastly, the FPC is an undeniable insurance policy in a project's success. Is doing without one worth the risk?

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## So beautiful or so what

When putting your name on a valuation, if the brand is good, own it; if it isn't, then value and price are not the problems

What strong DNA can do

NAME	TEV*/LTM** EBITDA	TEV/LTM REVENUE
The Coca-Cola Co.	14.07x	3.69x
Google Inc.	12.37x	4.65x
McDonald's Corp.	11.89x	4.25x
Apple Inc.	10.29x	3.38x
IBM Corp.	8.83x	2.19x
Microsoft Corp.	6.32x	2.68x
AT&T Inc.	6.06x	1.88x

\* total enterprise value  
\*\* last 12 months

In the context of determining the value of a business, one key driver of value is the business's culture — that is, *what* is a brand, *how* to best get a good understanding of it and why it is important.

Two good books that help examine brand-related matters are Ted Matthews' *Brand: It Ain't the Logo* and Walter Isaacson's *Steve Jobs*.

Matthews' book defines "brand" as: "what people think of you, it's everything. It's every touch point that anyone ever has with the business. It must be owned by the CEO — it's that important. It is the sum total of every experience with and all touch points of an organization. It is the personality of the company, product or service ... and it is judged by every stakeholder including customers, suppliers and employees and their families. The only synonym for brand is culture. Interestingly, in one sense, the company does not own the brand — all the people who think about the company or its product own it."

Matthews sees the development of the brand and the audience for the brand as a continuous feedback loop. All corporate stakeholders are nurtured by the brand and, in turn, rejuvenate it. It's not the logo, the advertising, the name or unique colours. It is the corporate culture — its DNA — that creates enduring goodwill value.

Matthews rhetorically asks, so who owns a real brand? Clearly all the stakeholders. For example, Volvo's brand is safety; Mercedes, engineering; Google, "the world's information;" Apple, perfect products; and FedEx, reliable delivery — just ask *Castaway's* Tom Hanks.

(To see what a strong culture and DNA have done for some brands' corporate values, compared to any lesser norm, see table above.)

Why not hear about real brand or culture from Steve Jobs and his team at Apple? The following quotes are exciting in and of themselves, but they also show how ephemeral, but obvious, that culture is.

Mike Markkula, an early Apple investor, director and trusted adviser, wrote his principles in a one-page paper,

“The Apple Marketing Philosophy,” which stressed three points. The first was empathy, an intimate connection with the feelings of the customer: “We will truly understand their needs better than any other company.” The second was focus: “In order to do a good job of those things that we decide to do, we must eliminate all the unimportant opportunities.” The third and equally important principle, awkwardly named, was impute. It emphasized that people form an opinion about a company or product based on the signals that it conveys. “People *DO* judge a book by its cover,” he wrote. “We may have the best product, the highest quality, the most useful software etc.; if we present them in a slipshod manner, they will be perceived as slipshod; if we present them in a creative, professional manner, we will *impute* the desired qualities.”

Regis McKenna, Apple’s long-standing publicist and communications guru, said, “The defining precept of Jobs’ design philosophy was the same as Leonardo da Vinci’s ‘simplicity is the ultimate sophistication.’”

According to Matthews, the many two-day retreats Jobs held every six months reemphasized his discipline: “The first [rule] was ‘Don’t compromise.’ It was an injunction that would, over time, be both helpful and harmful. Most technology teams made tradeoffs. The Mac, on the other hand, would end up being as ‘insanely great’ as Jobs and his acolytes could possibly make it — but it would not ship for another 16 months, way behind schedule. After mentioning a scheduled completion date, he told [employees], ‘It would be better to miss than to turn out the wrong thing.’ A different type of project manager, willing to make some tradeoffs, might try to lock in dates after which no changes could be made. Not Jobs. He displayed another maxim: ‘It’s not done until it ships.’

“Another of Jobs’ maxims at the retreat was ‘It’s better to be a pirate than to join the navy.’ He wanted to instill a rebel spirit in his team, to have them behave like swashbucklers who were proud of their work but willing to commandeer from others. As Susan Kare put it, ‘He meant, let’s have a renegade feeling to our group.’”

Jony Ive, the design genius at Apple and Jobs’ most kindred spirit, was quoted as saying: “I remember very clearly Steve announcing that our goal is not just to make money but to make great products. What I really despise is when I sense some carelessness in a product. ... I discovered the Mac and felt I had a connection with the people who were making this product,” he said. “I suddenly understood what a company was, or was supposed to be. ... Simplicity isn’t just a visual style. It’s not just minimalism or the absence of clutter. It involves digging through the depth of the complexity. To be truly simple, you have to go really deep. Jobs had aimed for the simplicity that comes from conquering complexities, not ignoring them. It takes a lot of hard work,” [Ive] said, “to make something simple, to truly understand the underlying challenges and come up with elegant solutions.”

Phil Schiller, Apple’s marketing chief, said: “Jobs kept impressing on us that the design was integral to what would make us great. Design dictated the engineering, not just vice versa. At

most other companies, engineering tends to drive design. The engineers set forth their specifications and requirements, and the designers then come up with cases and shells that will accommodate them.”

Jobs said: “If you don’t cannibalize yourself, someone else will.”

In a conference call with analysts shortly after Jobs went on leave, Tim Cook, chief operating officer under Jobs and current CEO, departing from his unemotional style, gave a rousing declaration of why Apple would continue to soar even with Jobs absent: “We believe that we are on the face of the earth to make great products, and that’s not changing. We are constantly focusing on innovating. We believe in the simple not the complex. We believe that we need to own and control the primary technologies behind the products that we make, and participate only in markets where we can make a significant contribution. We believe in saying no to thousands of projects, so that we can really focus on the few that are truly important and meaningful to us. We believe in deep collaboration and cross-pollination of our groups, which allow us to innovate in a way that others cannot. And frankly, we don’t settle for anything less than excellence

## **It is not the logo, the advertising, the name or unique colours. It is the corporate culture — its DNA — that creates enduring goodwill value**

in every group in the company, and we have the self-honesty to admit when we’re wrong and the courage to change. And I think, regardless of who is in what job, those values are so embedded in this company that Apple will do extremely well.”

About the legacy he wanted to leave, Jobs was quoted as saying: “My passion has been to build an enduring company where people were motivated to make great products. ... Edwin Land of Polaroid talked about the intersection of the humanities and science. I like that intersection. There’s something magical about that place. There are a lot of people innovating, and that’s not the main distinction of my career. The reason Apple resonates with people is that there’s a deep current of humanity in our innovation. ... That’s how you really make a contribution and add to the legacy of those who went before. You build a company that will still stand for something a generation or two from now. That’s what Walt Disney did, and Hewlett and Packard, and the people who built Intel. They created a company to last, not just to make money. That’s what I want Apple to be.”

Everyone knows that business and securities value depends on future earnings potential and that potential is often quantitatively measured by a discounted cash flow analysis or some multiple of anticipated cash flows. The key inputs, the cash flows themselves, the discount rate and the multiple, are in turn impacted by a broad array of qualitative factors.

One essential qualitative factor is the quality of management. How best to assess this in a timely and efficient fashion? There are numerous techniques for interviewing, researching,

investigating and interacting with management to assess their capabilities. This article does not focus on such methods. Gritty enquiry needs to be made of all the business stakeholders — not just management. Depending on the weight to be given to the valuation, almost the same kind of care and attention should be given to assessing the quality of management as would be undertaken in the course of a business purchaser's due diligence. One important mark of the quality of management is the culture of the firm — its brand, as Matthews defines it.

The framework Matthews sets out for the development and the analysis of culture and brand is as follows:

- core purpose — why you exist;
- vision — where you are going and how you will know you're there;
- mission — what you do every day to get there;
- values — what you believe in, your principles;
- position — how you are different;
- positioning statement — how you say you are different;
- character — how you act, your voice; and
- job description — does everyone's job include building the brand and does the CEO feel he or she has more responsibility for this than the others?

How much of Jobs' philosophy will be a lasting legacy or will become Apple's institutional culture? How much of it is simply personal goodwill with no commercial value? In the article "Apple without a core," *Report on Business*, January 2012,

Timothy Taylor asked how valuable an asset is taste. He suggests that two of Apple's key brand attributes were Jobs' taste and personal energy and Jobs himself as their unifying symbol. Without Jobs, he suggests, the brand will be much more vulnerable to competitors. In support of this he quotes Jobs: "The only problem with Microsoft is they just have no taste. People like symbols. So I'm the symbol for certain things." While journalists have the luxury of only raising the question, investors and valuers don't get off so easy.

Maybe Paul Simon was also talking about business culture and a sense of ownership, appreciation, care and a vitality that is distinctive to great brands when he wrote "Life is what you make of it" in the song *So beautiful or so what*.

*Ain't it strange how we're ignorant, how we seek out bad advice  
How we jigger it and figure it  
Mistaking value for the price.*

When placing your name on a valuation or your money behind a purchase, if the brand/culture is so beautiful, don't be afraid to bump the multiple up, lower the discount rate, own it, pay up, empower/reward the team and leave them with real incentives. And if it smells like "so what," there may be bigger problems than value and price.

Stephen Cole is managing director with Duff & Phelps in Toronto. He is *CAMagazine's* technical editor for Business valuation

## Public Sector Accounting Board

The Accounting Standards Oversight Council (AcSOC) is pleased to announce the appointment of Rod Monette, FCA, as Chair of the Public Sector Accounting Board (PSAB), effective May 1, 2012.



Rod Monette

After earning his CA designation with the firm Clarkson Gordon, Mr. Monette spent 28 years with the federal government. For 17 of those years, Mr. Monette served as an Assistant Deputy Minister and Deputy Minister. He has held the positions of Comptroller General of Canada, Associate Deputy Minister of National Defence, and Chief Financial Officer for the Departments of National Defence, Public Works and Government Services Canada and Environment Canada. Mr. Monette currently serves on two federal departmental audit committees, as Chair for Statistics Canada, and a member for Human Resources and Skills Development Canada.

In 2012, he was awarded the CMA-CIPFA Lifetime Achievement Award for his outstanding contribution to comptrollership throughout his career. Mr. Monette has been a member of PSAB since 2008.

The Public Sector Accounting Board (PSAB) was created to serve the public interest by establishing accounting standards and providing guidance for financial and other performance information reported by the public sector.

The Accounting Standards Oversight Council (AcSOC) is an independent, volunteer body established by the Canadian Institute of Chartered Accountants in 2000. It serves the public interest by overseeing and providing input on the activities of the Accounting Standards Board (AcSB) and the Public Sector Accounting Board (PSAB). AcSOC's responsibilities include appointing AcSOC, AcSB and PSAB members. Reporting to the public and made up of representatives that include regulators, investors and other users, preparers and auditors of financial reports, AcSOC brings a broad perspective to complex issues facing standard setters in both the private and public sector.





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# Outlook

BY MARCEL CÔTÉ

WHERE ECONOMICS AND POLITICS MEET

## The will to innovate

**T**he book *Innovation Reinvented*, which I coauthored with Roger Miller, undermines many of the foundations of current public policies on innovation. As I wrote last month, competition is the prime driver of innovation in any industry. However, competition is not enough: business also has to choose to compete on innovation. It seems that in Canada, these two conditions — competition and the strategic will to innovate — are not encountered in sufficient quantity. A dearth of innovation is the prime factor behind our 25% shortfall in productivity (measured as output per hour worked) vis-à-vis the Americans.

Federal and provincial governments believe that Canadian innovation will improve if the cost to do so is lowered through subsidizing business R&D. And Canada subsidizes R&D more than any other country. There are two flaws in that reasoning.

First, the major cost of innovation is not R&D; marketing and process-change costs trump R&D. Customers need to be informed and sold on new products and reaching them costs more than the R&D behind the innovation. When innovation is a process, implementing the changes required for the improved process to function typically costs more than the R&D to develop it.

But the thinking is wrong on a second point: costs have little to do with the decision to innovate. Companies such as Research in Motion and Procter & Gamble need new products every year to remain competitive. Costs may be important when choosing project A or project B, but not on the decision to innovate. (A subsidy will influence which type of project will be pursued, namely the ones that can be subsidized, but will not necessarily generate more innovation.) Nevertheless, it is well known that business will take any subsidy thrown its way and will gladly provide a rationalization for its virtue.

Most innovations are incremental, improving what is already in the marketplace or improving production processes. Products and processes continually evolve.

Public policies should encourage constant improvement, which usually occurs in small steps and with much trial and error. Ironically, in certain areas and sectors, such as life sciences, governments put up regulatory roadblocks that discourage incremental innovation, although they generously subsidize research. The results speak for themselves: despite governments “investing” more than \$2 billion a year in life science for the past 20 years through research subsidies and R&D tax credits, employment is down in the innovative pharmaceutical and biotech sector, and there is only one Canadian-based company, Valeant Pharmaceuticals International Inc., with a market capitalization of more than \$1 billion.

How can business be encouraged to experiment with improved products and improved processes? There is no

### Business needs more than a slight reduction in costs to embark on an innovation strategy

easy answer. Reducing R&D costs that underlie the experimentation doesn't do it. Business needs more than a slight reduction in costs to embark on an innovation strategy.

Success breeds success. Having more Canadian companies excelling at innovation creates models that pave the way for others. Research in Motion was such a model until it hit a rough patch. Bombardier was one in the '80s. But Canada does not have many such models: we let foreign companies buy our jewels. What's left of Ottawa's Silicon Valley? The demise of Nortel has laid bare the fact that all its offspring were sold and there are no more models.

Would it have been good for Canada if Bombardier had been sold to a Japanese company when it faced trouble in 1980 and in 2005? Thankfully, its dual-class structure prevented that. Government policies wouldn't have stopped it.

We need to rethink our innovation policies, starting with a blank page. Let's put all our sacred cows on the table, such as R&D tax credits and our national indifference to Canadian ownership.

Marcel Côté is founding partner, SECOR Consulting, Montreal



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