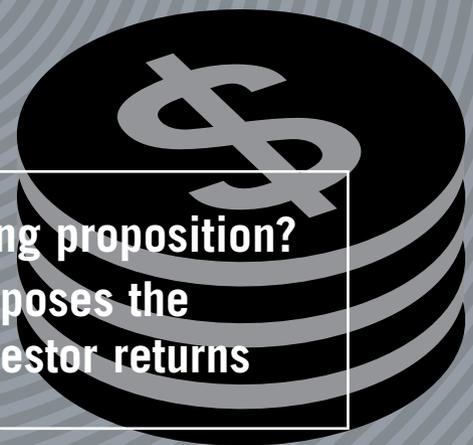


# THE PERSONAL financial planning issue

Are mutual funds a losing proposition?  
OUR MONEY EXPERT exposes the  
hidden fees eroding investor returns





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PAUL ORENSTEIN

## PFP, informative and entertaining

Here is our annual look at personal financial planning and how you can assist your clients

Accountants know a lot about the financial situation of their clients, but how many are actually involved in, or can provide, personal financial planning for their clients? If you guessed from that opening line that this is our personal financial planning issue, you would be right (and no brownie points for you because we do this every year). The discrepancy between what accountants do in finance and their scarce numbers among those who provide PFP advice and information has been dealt with several times in this magazine.

The writer of our first feature is not one of those accountants who cannot provide PFP advice: David Trahair, CPA, CA, is the author of five books on personal financial issues, and he gives seminars to accountants about the topics in his books. In "Funds without benefits," p. 18, the highly entertaining Trahair tells us why, like Taylor Swift who wrote a song about why she would never get back together with actor Jake Gyllenhaal, he wrote a book about why he would never get back together with mutual funds.

So why did he break up with mutual funds? He says that while they seem good looking on the surface, they are expensive to run. Interesting. Learn more in this informative and entertaining article.

Our next PFP feature explains how more accountants can provide personal financial planning in an indirect way. In "It takes a team," p. 24, Luke MacLennan, CPA, CA, and Gord Hardie, CFP, show how an accountant's "knowledge and experience can be integrated into the financial planning process" to benefit the client.

Hardie and MacLennan use the case of a couple named John and Mary who have been clients of accountant Charlotte to show how this can be done. Charlotte introduces the couple to financial planning services available through her firm, and offers to sit in on meetings with the financial planner. She provides the planner with their financial information and a listing of assets and explains to him the family dynamic. Please do read this highly informative feature.

The final PFP story also uses the case study method to explain how professional accountants can provide wealth management services to their clients. In "Wealth taken care of," Paul Tyers, CPA, CA, CFP, CIM, shows how a team of experts was brought together to handle the assets of \$40 million of a family involved in real estate. The wealth management team assembled included an accounting firm, a valuator, a law firm, an insurance agent and a business transition adviser. Read the details on p. 30.

In this issue we also have regulars on people management, education, standards and fraud.



Okey Chigbo, Editor

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BY PAUL TYERS



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NEEDLE  
IN THE  
HAYSTACK.  
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Big increase in mobile use for business: see [camagazine.com/mobile13](http://camagazine.com/mobile13)

Lack of savings tops list of financial concerns for US consumers: see [camagazine.com/savings13](http://camagazine.com/savings13)



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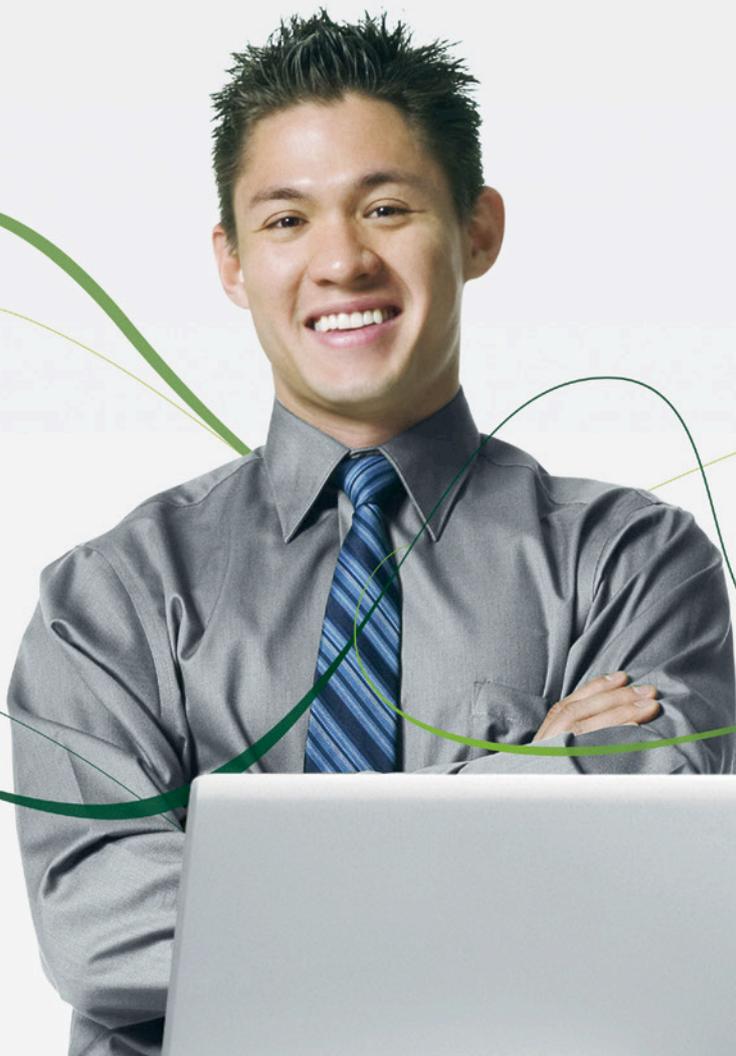


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# UPFRONT

News, people, briefs, trends + tips

## Spin doctor

**W**hen Derek Silverman, a partner at Bessner Gallay Kreisman, suggested converting one of the boardrooms at the Montreal-based firm into a spinning class/gym room in 2010, the other partners were stunned. “No way. Too out-of-the-box. And what about the cost for the bikes?”

But they came around. “How could they not?” asks Silverman. “Where was the downside? We would have a healthier, more alert and attentive staff, fewer sick days, build an atmosphere of great camaraderie and on and on. It could only be a win win.”

It didn’t take long before Silverman knew he had hit the jackpot. Within 10 minutes of sending an email to all employees outlining his idea, “my inbox was ringing,” he says.

Silverman had been suffering chronic back pain due to a herniated disc and, at about the time he joined BGK in 2001, his physiotherapist introduced him to a personal trainer. “He changed my life and provided me with the confidence to push myself harder and longer,” he says. That regime eventually led to spinning.

For those not familiar with this discipline, spinning is not simply pedaling on a stationary bike in an empty gym, idly whistling a tune while cranking up the volume on your iPod. It is a very demanding routine that simulates sprints, uphill climbs and dashes for a final victory. “After an hour, you are completely drained,” says Silverman.

He enjoyed the activity so much, he decided to become a certified spinning instructor and pay it forward. “I knew what spinning brought to me; I just wanted to bring it to others,” Silverman says. “And in what better place than in the office?”

### Résumé

- 1988** obtains CA designation (Que.)
- 2001** joins Bessner Gallay Kreisman, Montreal
- 2006** starts taking spinning classes
- 2010** becomes certified spinning instructor



**Spinning instructor Derek Silverman convinced the other partners at his Montreal firm that an in-house studio was not just a healthy proposition for staff, but for the bottom line as well**

The classes at BGK, which have been held for the past three years, attract about 30 of the firm’s 100 employees, and most classes have a waiting list. Another employee is now leading zumba classes. The firm’s partners have even caught the spinning bug, with five of them now joining in. “That’s one-third of the partner group,” says Silverman triumphantly, adding that the benefits to the firm go beyond the physical. “It’s a huge draw come recruiting time.”

Yan Barcelo

PAUL ORENSTEIN

# #NUMBERS Game

**Tax returns** The only thing more certain than paying tax is people legally trying to avoid them. A short history of popular tax-friendly investment schemes:

**1** Millions of Canadians investing in registered education savings plans in 1999, up 40% from 1998, when then finance minister Paul Martin sweetened federal incentives to invest.

**2** Billions of dollars in revenue lost by the federal government in 1984 and 1985 through the short-lived scientific research tax credit program. The program was criticized after firms performed “quick flips” and sold the credits at a discount.

**16** Percent decline in value of income trusts in the two days following a 2006 federal announcement to tax them. The popular investment vehicle was the 1984 brainchild of a Royal Trust fund manager.

**73.9** Billions of dollars in tax-free savings accounts in Canada in



June 2012. Introduced in 2008, TFSAs were called the “most significant, positive innovation in Canada’s tax treatment of savings since RRSPs.”

**150** Millions of dollars invested in Canada’s film industry in 1979 thanks to a generous tax shelter. Investors often lost money on films.

**1957** Year Canada’s federal government launched the RRSP to help Canadians save for their post-work years. In 2011, nearly one in four eligible tax filers participated.

**5,000** Minimum investment in dollars to benefit from a multiple-unit residential building investment between 1974 and 1981. The popular tax shelter allowed individuals to defer taxes and claim deductions on expenses. Steve Brearton



## Working File: YES OR NO TO SUMMER CLOTHES?

### THE SCENARIO

After a long and icy winter, 31-year-old Kim Jones\* couldn’t wait to break out her summer wardrobe. She has been working in the same office for six years, but her manager was replaced in the spring by someone new who dresses to the nines. To avoid any faux pas, Jones checked the employee handbook online, but it didn’t have a clearly defined dress code. On the first double-digit-degree day of the season, she wore her jewel-toned flip-flops to work. When she walked into the office, her manager gave her the once-over, and Jones thought she noticed a disapproving look when her high-heel-wearing boss caught a glimpse of her sandals and sleeveless top.

### HOW IT PLAYED OUT

Jones immediately kicked off her flip-flops and changed into the pair of flats she kept under her desk. She also threw a cardigan over her sleeveless top.

### THE EXPERT WEIGHS IN

“Most accountants are advised to dress for the client if they have meetings, but for a day in the office, business casual is common,” says Erin Nadler, a fashion consultant and owner of Better Styled in Toronto. Of course, professional attire is still expected, so younger employees are wise to take their dressing cues from senior staff.

If your office has no specific dress code, Nadler offers these basic summer wardrobe guidelines: “Men can wear button-down short-sleeved shirts and dress pants; collared shirts tucked in with dress khakis; or lightweight sweaters with khakis. If jeans are allowed, try dark denim with a basic tee and a sport jacket. Women can wear skirts or dresses; coloured cropped pants and sweater sets; or long tunics belted with skinny pants.” As for flip-flops — best to save them for the weekend.

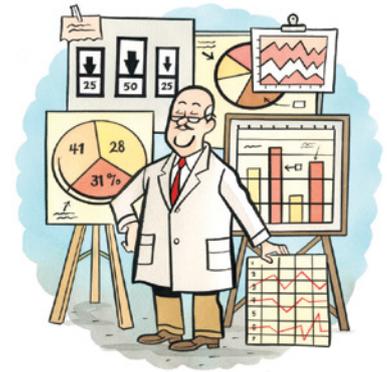
Lisa van de Geyn



Have you faced a tricky work situation? Tell us about it at: [tsatov@cpacanada.ca](mailto:tsatov@cpacanada.ca) Names can be changed for anonymity

\*Name has been changed

By Tamar Satov



## HOME SECURITY

How low can it go? That's the question market watchers, investors and homeowners have been asking about Canada's real estate market. Without the benefit of a crystal ball, here are three different takes on the future of the Canadian housing market.

by Steve Brearton

### Predicted decline in Canadian housing market



### 0%

**TD Economics:**  
Inflation will offset any gain from a "string of lacklustre performances" over the next few years

### -11.5%

**International Monetary Fund:**  
With more government intervention, expect a "soft landing" over the next five years

### -44%

**Moody's Investors Service:**  
If there is a severe economic shock, home prices will suffer "due to the misalignment of current house prices with historic fundamentals"

## A slice of office life

Ever wonder how your daily routine compares to others'? Using an online poll of 3,900 workers in late 2012, US recruiter CareerBuilder crunched the numbers and came up with this picture of the average work day:

**Breakfast of champions:** cereal (31%), toast/bagel (29%), fruit (19%), eggs (19%), oatmeal (18%), doughnut (6%), nothing (23%).

**Getting there:** car (83%), train (5%), bus (3%), walk (3%), bike (1%).

**Eat lunch at desk:** every day (39%), three to four times a week (18%), once or twice a week (43%).

**Most common distractions:** chatting with coworkers (34%), online searches (22%), loud coworkers (18%), personal calls/emails (17%), office drama (15%), daydreaming (11%), gossip (7%), not understanding how to do the work (4%), watching TV (2%).

**Hours actually working:** 8 (38%), 7 (21%), 6 (18%), 5 (11%), 4 or less (12%).

### NEW WAY TO OWE THE TAXMAN

For the why-pay-today-what-you-can-pay-off-till-tomorrow crowd: Canadians can now pay their personal income taxes by credit card. US-based online payment provider Plastiq lets taxpayers remit payments to the Canada Revenue Agency by American Express, Visa or MasterCard — for a fee of 2% per transaction. Plus interest, of course.

### WORKIN' FOR A LIVIN'?

One-quarter of teens expect to be financially dependent on their parents until age 25 to 27 — twice as many as in 2011 — finds a US survey of 14- to 18-year-olds. The poll, conducted by Junior Achievement USA and The Allstate Foundation, also shows only 9% of teens are saving money for higher education.

### TRUTH ABOUT TELECOMMUTERS

If you think it's mostly moms who work from home, think again. While it's true parents are more likely to telecommute than those without kids (41% vs. 31%), overall men are more likely than women to work from home (37% vs. 31%), according to a Harris Interactive poll of more than 2,200 US adults.

BAIBA BLACK



## PERSONAL ACCOUNTS

### My recovery from anorexia

Heather Coburn, CA, author of *The Perfect Imperfect Me!*

I loved life up until Grade 8. In Grade 9, I started to fill out even though I was an athlete. I won the Canadian National Tennis Championships and nine provincial tennis titles. But I wasn't happy.

I thought if I lost weight I'd start feeling better. When that didn't work, I lost more and more. I was miserable, but I'd think to myself, at least I'm thin.

I went to the University of South Carolina on a tennis scholarship, and I spent my entire time there feeling lost, alone and empty. It took me 10 years after finishing university to recover from anorexia, and it wasn't until my third inpatient hospitalization (and a six-month absence from Clarke Starke & Diegel during our busy season) that I finally recovered.

Not many people recover from this disease, and when I realized that I'd finally beat it, I knew I wanted to write my book and share the life lessons I learned. Until you've gone through something difficult — and everybody does — you can't appreciate what you have. I finally love life again.

As told to Lisa van de Geyn

## QUOTABLE

### Rules not to blame

“In the early phases of the financial crisis, it was fashionable to argue that the US system of regulation needed a fundamental structural overhaul. Little has come of these arguments. The truth is that it is hard to identify any correlation between regulatory structure and success in heading off or responding to the financial crisis”

Howard Davies, former chairman of Britain's Financial Services Authority, February 2013

# 70

## YEARS AGO THIS MONTH

Compiled by Steve Brearton

From the July 1943 edition of our magazine

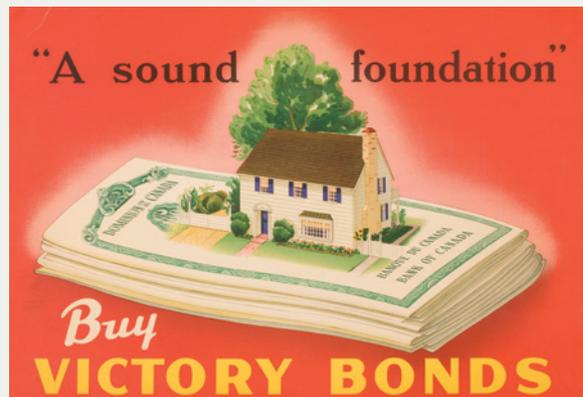
### Ain't no river wide enough (to keep him from you)

“Sometimes we are put out when we find that our client is so cramped for space that it is difficult to find a desk for the auditor. This occasion presented a different problem. The Red River was in flood with the result that the auditor had to obtain a boat to reach the office and obtain the records. Fortunately there were only three feet of water on the floor and the majority of files and documents had been placed on shelves above that height.”

Milton Howard, CA, on how auditors obtain records in the (not very far) north

### Even during wartime, accounting is essential

“Owing to the circumstances of war, conventions can not be on as lavish a scale as formerly. The spirit of the present war is not



quite in accord with the ‘business as usual’ slogan of the last war, but if we described it as ‘essential business as usual’ we would not be far off the mark. And the field of accounting and auditing stands high in the rating of essentiality.”

Editorial on the coming annual meeting of The Dominion Association of CAs



# Must Haves

by Alan Vintar



## Audiowood Barky Turntable

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able brass legs. Sound is delivered through UK-based Rega Research Ltd.'s extremely stable RB303 tonearm equipped with a high-performance Elys 2 cartridge. The Barky is custom order, so be prepared to wait up to three weeks for delivery.

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[www.audiowood.com](http://www.audiowood.com)

## Going Concern



**ALAN NORRIS**  
**PRESIDENT & CEO, BROOKFIELD**  
**RESIDENTIAL PROPERTIES INC.**

**COMPANY PROFILE:** One of the top six land developers and homebuilders in North America, Brookfield Residential Properties

has operations in 11 markets, from Alberta to Los Angeles. Launched in 2011, the company is the result of a merger between Brookfield Homes Corp. and Carma Developers, which was formed in Alberta in 1958. Still headquartered in Calgary, the new company has 770 employees across Canada and the US, with annual revenue of \$1.3 billion in 2012.

**HOT FACTOR:** With hands in both land and housing developments, Brookfield has a leg up on US competitors focused only on home building. With half its assets in Canada, the company was also better able to weather the recession, retaining its properties and even gaining new ones. Late last year, it acquired Playa Capital Co., which

includes 65 acres of land near the LA oceanfront. It also partnered with the California State Teachers' Retirement System to develop more than 2,500 lots in a highly desirable part of northwest Calgary.

**COOL PROJECTS:** Among its roster of ongoing projects is a town centre in southeast Calgary called Seton. The 365-acre mixed-use development, among the largest of its kind in North America, is anchored around a brand new hospital and features 2.5 million square feet of office and retail space. Plans include light-rail transit, a regional park, high school, recreation centre and hotel, among other amenities. Brookfield is also developing four residential communities in close proximity to the area within the next decade.

**IN HIS OWN WORDS:** "In the last few years, 'land' was a four-letter word, but with the tightening of supply on the housing side our positioning and patience during the downturn has paid off. We think we can be a very valid supplier of land as opportunities present themselves in the US and Canada."  
Rosalind Stefanac



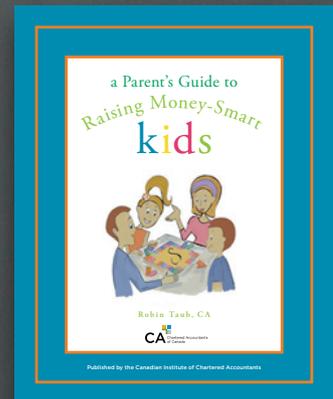
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# System selection

BY MICHAEL BURNS

FINDING THE RIGHT SOFTWARE TO FULFILL YOUR BUSINESS NEEDS

## CRM survey 2013

**W**hen Dina and Darrell are out on the road these days, they can do much of what they need to do — from responding to leads to accessing sales records — without ever leaving the comfort of their mobile devices. Not only that, but they can track the effectiveness of their campaigns and check who said what about their company on Facebook, all thanks to their customer relationship management software (CRM).

Although CRM has been around for some time now, new mobile functionality and social networking are fueling adoption of the technology. In fact, IT research firm Gartner expects CRM to become a top priority for IT spending on enterprise applications, even more so than ERP.

As our 2013 vendor survey shows, there are already many solutions available today. The leading ones are available mostly in the cloud and older systems are having a hard time competing. For example, Sage recently sold ACT and SalesLogix, explaining that it wanted to focus on its core strengths. However, you have to wonder whether the company also felt unable to compete with all the new CRM systems in the cloud.

CRM systems can be used for a lot more than just tracking customers, marketing, sales and service. I was recently involved with a client that was able to use CRM to automate many other aspects of its business because of the customization tools that come with some CRM systems on the market.

But no matter how many bells and whistles are included, and no matter how easy it is to access CRM in the cloud, some people are reluctant to embrace the technology. They don't want to spend the time to keep the information up to date or give away their insight (and power) by disclosing key information to everyone in the company. Change management is key in the implementation of any CRM system to make sure employees are motivated to get on board.

This year, we have added a number of questions to our survey. These are

related to synchronization with Google, Apple and Outlook, as well as calendar management and social networks. You'll find the actual results of the survey in pdf form by visiting [www.camagazine.com/CRMSurvey13](http://www.camagazine.com/CRMSurvey13).

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: [m burns@180systems.com](mailto:m burns@180systems.com)

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## CGA bodies return to unification talks

The Chartered Professional Accountants of Canada has welcomed the return of several certified general accountant (CGA) organizations to unification. With these returning bodies included, organizations representing almost 90% of Canada's professional accountants are now committed to unification under the chartered professional accountant (CPA) banner.

Earlier on, most CGA bodies withdrew from the unification discussions; however, some provincial organizations eventually returned. Recently, CGA-Canada, the designation's national body, along with its international affiliates in Asia and the Caribbean and CGA bodies in the Northwest Territories/Nunavut, Yukon, Prince Edward Island and Nova Scotia, announced they are rejoining the discussions. With this announcement, the only CGA organizations not participating in unification are Ontario and Manitoba.

"CGA-Canada is guided by the best interest of all our members, CGAs and the profession," says Anthony Ariganello, president and CEO of CGA-Canada.

"We have entered this round of discussions with renewed optimism and based on the feedback from our affiliates. Our focus is on ensuring the success and opportunities of our members, all certified general accountants and students, now and in the future."

Unification has already taken place in Quebec. CPA Quebec and the Institute of Chartered Accountants of Ontario became the first organizations to join CPA Canada, which was formed earlier this year. Other provincial bodies will join CPA Canada once implementing legislation is passed.

If unification is achieved with the current participants, the CPA profession will be more than 150,000 members strong and better positioned to represent the interests of members both in Canada and on the global stage.

"This is a positive and significant step forward," says Kevin Dancey, FCPA, FCA, CPA Canada president and CEO. "Our goal has always been to achieve unification of the entire Canadian accounting profession. Unification will enhance the influence, relevance and contribution of the Canadian accounting profession both at home and internationally."

More information about the unification effort can be found at [www.cpacanada.ca](http://www.cpacanada.ca).

### Survey finds a common technology-related priority

Managing and retaining data is the top technology-related priority for Canadian and US accounting professionals, according to a joint survey by CPA Canada and the American Institute of Certified Public Accountants.

The survey asked respondents to prioritize their top technology initiatives for this year.

"Many organizations are facing increased risks associated with data management because of an explosive growth in volume and the complexity of information being handled," says Frank Colantonio, CPA, CA\*IT, director of continuing education, CPA Canada. "However, in this era of big data, effective management will ultimately lead to better business decisions and service for clients."

While data oversight was the top priority, it was closely followed by securing the IT environment by respondents in both countries.

The survey took place mid-February to early March. See [www.cica.ca/toptech](http://www.cica.ca/toptech) for more information.

## CPA Canada introduces national e-newsletter

The Chartered Professional Accountants of Canada recently launched a national e-newsletter called *CPA Today*. This monthly publication provides CA, CMA and CPA members with updates on the latest news (including unification updates) and profiles the most recent additions to the wide range of valuable products, services and resources available for Canada's accounting and business professionals.

"With *CPA Today*, members have one central information source where they can get news updates, find out about upcoming events and learn about the latest resources that CPA Canada

has to offer," says CPA Canada's Heather Whyte, vice-president, strategic communications, branding and public affairs.

*CPA Today* is distributed to all CPA Canada members, as well as to CAs and CMAs on behalf of the Canadian Institute of Chartered Accountants and The Society of Management Accountants of Canada.



*“We need an accountant  
that knows the industry as well as we do.”*

---

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## Profession-wide compensation survey: a benchmarking opportunity for members

A profession-wide compensation survey to be conducted by the Chartered Professional Accountants of Canada will enable members to benchmark their compensation against other members in their region. The survey results will also help promote the profession to students across Canada.

In early June, members will receive an email invitation to participate in the survey from Itracks, one of CPA Canada's research providers. Participants will receive an advance copy

of the results in early September. The complete results of the study will be available to all members by mid-October.

The compensation survey is hosted on a secure site and all information entered is kept strictly confidential. Results will be reported in aggregate form only.

If you have any questions regarding the survey, please contact Paul Long, manager, marketing and marketing research, at [plong@cpacanada.ca](mailto:plong@cpacanada.ca).

## New report on what professional investors value in an organization's financial reporting toolbox

While it's no surprise that professional Canadian investors find most of the information they need in an organization's financial report — including financial statements, management's discussion and analysis, annual information form and management proxy circular — many wish that organizations would present information in a single omnibus report to minimize duplication and allow for easier searching of financial data.

Market Value: Professional Investors' Views about Financial Reporting in Canada, a report developed by the Chartered Professional Accountants of Canada, PricewaterhouseCoopers and Veritas Investment Research, summarizes more than 30 interviews with chief investment officers, portfolio managers and buy- and sell-side analysts.

"The most requested financial reporting improvement interviewee investors mentioned was around the disclosures of calculations of non-GAAP measures," says Chris Hicks, CPA, CA,

principal at CPA Canada. "They want more comparability across reporting periods and between peers."

The publication highlights Canadian professional investors' experience regarding the transition to international financial reporting standards; how they use financial reports; the information they use in decision-making; their views on non-GAAP measures; and areas of reporting that should be improved.

Overall the interviewee investors stated that while they were generally satisfied with the information they received from organizations, there are opportunities to increase the effectiveness and clarity with regard to organizations' communications with stakeholders. "Investors identified several key areas for improvement in reporting beyond non-GAAP measures, including segments, pension solvency and more concise, relevant and readable note disclosures," Hicks said.

Visit the Performance Reporting Resource Centre online to download the report at [www.cica.ca/cpr](http://www.cica.ca/cpr).



## International financial literacy award for CPA Canada book

*A Canadian's Guide to Money-Smart Living*, published by the Chartered Professional Accountants of Canada to help individuals become better money managers, received international recognition by winning a prestigious Excellence in Financial Literacy Education Award.

The special guide was named Adult's Book of the Year, Credit by the US-based Institute for Financial Literacy.

Now in their seventh year, the awards were created to acknowledge innovation, dedication and the commitment of individuals and organizations that support financial literacy education worldwide.

"We are honoured to be recognized," says Cairine Wilson,

vice-president of member services, CPA Canada. "Each chapter of the book deals with an essential aspect of money management and outlines easy action steps."

Managing cash, credit cards and other debt are among the topics covered in the book. The author is Kelley Keehn (pictured left), one of Canada's most prominent personal finance experts and a passionate advocate for improving the financial literacy of Canadians.

"We produced the book to provide guidance and support, and this award is a wonderful acknowledgment of that goal," says Keehn.

*A Canadian's Guide to Money-Smart Living* was originally published by the CICA and can be obtained by visiting [www.castore.ca/moneysmartliving](http://www.castore.ca/moneysmartliving).

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

## RECENTLY ISSUED PRONOUNCEMENTS

<b>CICA Handbook – Accounting</b>	<b>Date issued†</b>
<b>Part I</b>	
Amendments Regarding Incorporating IFRSs into Canadian GAAP	July 2013
<b>Part II</b>	
Section 3462, Employee Future Benefits	May 2013
Section 3475, Disposal of Long-lived Assets and Discontinued Operations (revised)	May 2013
<b>CICA Handbook – Assurance</b>	
CAS 610, Using the Work of Internal Auditors (revised)	May 2013
<b>CICA Public Sector Accounting Handbook</b>	
Section PS 2125, First-time Adoption by Government Organizations (revised)	May 2013

## RECENTLY ISSUED DOCUMENTS FOR COMMENT (to June 30, 2013)

<b>Accounting</b>	<b>Comment deadline</b>
ED 2013 Improvements to Accounting Standards for Private Enterprises	June 1, 2013
EDI Bearer Biological Assets	September 30, 2013
ED Consolidated Financial Statements	October 15, 2013
EDI Fair Value Measurement: Unit of Account	September 30, 2013
EDI Financial Instruments: Expected Credit Losses	July 5, 2013
SOP Improvements to Not-for-Profit Standards	September 15, 2013
ED Joint Arrangements	October 15, 2013
EDI Regulatory Deferral Accounts	September 4, 2013
ED Reporting Employee Future Benefits by Not-for-Profit Organizations	September 15, 2013
<b>Auditing and Assurance</b>	
ED Standards for Review Engagements	October 11, 2013
<b>Public Sector</b>	
SOP Improvements to Not-for-Profit Standards	September 15, 2013
rED Related Party Transactions	September 4, 2013

### WATCH FOR

<b>Amended Standards</b>	Amendments to IFRS 9 Regarding Hedge Accounting Annual Improvements to IFRS 2010 – 2012 Cycle
<b>Documents for Comment</b>	Leases and Insurance Contracts (AcSB EDIs) Auditor Review of Interim Financial Statements (AASB ED) Other Reporting Where No Assurance Is Provided (AASB ED)

#### Legend

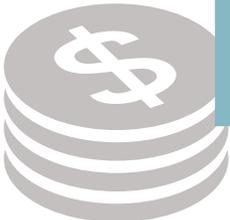
ED – Exposure Draft  
rED – Re-exposure Draft

EDI – ED based on IFRS/ISA  
SOP – Statement of Principles

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

Personal finance author **David Trahair** explains why he's had it with hidden fees and will never ever buy another mutual fund

# FUNDS without BENEFITS



**COUNTRY MUSIC STAR TAYLOR SWIFT IS SO SURE SHE IS NEVER EVER GETTING back together with actor Jake Gyllenhaal that she wrote a song about it. Likewise, I'm so done with mutual funds that in 2009 I wrote a book about it — *Enough Bull*.**

What's my beef with mutual funds? On the surface, they sound like a pretty good idea. They offer exposure to literally any asset type in almost any region on earth. They reduce the extreme risks of choosing individual stocks by allowing you to buy a basket of investments. And they allow you to employ experienced financial experts to pick and manage investments on your behalf.

Problem is, actively managed mutual funds are expensive to run, which makes it difficult for investors to reap solid returns after the fund's management takes its cut. Some of these expenses are visible fees, such as the "load" or sales commission required to buy or sell a fund, and much has been written

illustration by RYAN SNOOK





# Canada has the highest annual expense ratios among 22 countries for equity and money-market funds, which means investors aren't getting the returns they should

about the various options (rear load, front load and no load).

However, in addition to these visible fees, there are hidden charges that, in many cases, are far more significant. That is because mutual funds pay ongoing fees and expenses relating to their operation and distribution.

These invisible fees lurk in the management expense ratio (MER) of the fund. They are paid from the fund assets and reduce the investor's net returns rather than showing up on the monthly statements as a charge. When mutual funds disclose their performance, the figures are net of these ongoing fees and expenses.

The MER is the total of the mutual fund's annual operating costs expressed as a percentage of the average daily value of the net assets of the fund. So, for example, if a fund had a \$100-million average net asset value and the costs on its income statement for the year were \$2 million it would have a MER of 2%.

Note that this excludes the "visible" brokerage commissions paid by the fund for buying and selling securities the fund owns, since these amounts are sitting in the cost of the investments until the investments are sold and are then reflected in the realized capital gain or loss when the investments are disposed of.

## Hidden fees revealed

In a 2011 study of 22 countries by investment research firm Morningstar, Canada was found to have the highest annual ex-

pense ratios for equity funds, the third highest for bond funds, and tied for the highest for money-market funds. As a result, Canada was given an F, a grade that no other country received. Equity funds are particularly expensive here — more than double that in the US. This is a major reason why many Canadian investors aren't getting the returns that they should.

Let's look at the long-term fees of a \$100,000 investment in a

Median asset-weighted expense ratios			
Type	Canada	US	Difference
Money market	0.80%	0.47%	0.33%
Fixed income	1.31%	0.75%	0.56%
Equity	2.31%	0.94%	1.37%

Source: Morningstar, "Global Fund Investor Experience, March 2011"

no-load equity mutual fund with an MER of 2% that grows at a rate of 5% per year for 10 years. (A 5% rate of return is a reasonable assumption, given that the Canada Pension Plan Investment Board has an investment return objective of 4% after inflation, which means it's hoping for an overall return of 6%.)

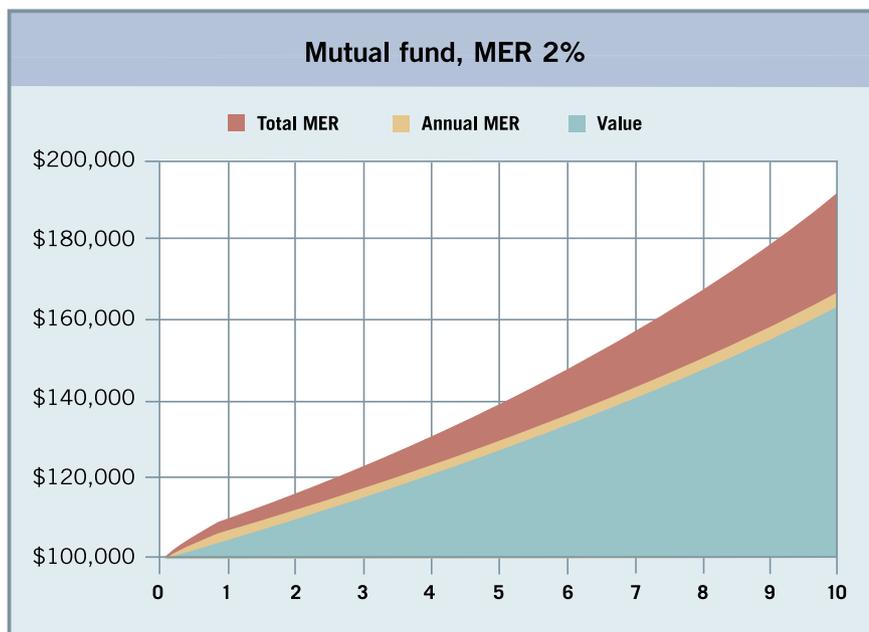
At the end of the 10-year period, the investment has grown to \$162,889 and the accumulated costs and fees deducted via the MER comes to \$25,785 (see chart bottom left). That is 41% of the actual growth of \$62,889.

Why would you give up this kind of money when there are much cheaper options?

## Low-cost option #1: ETFs

Exchange traded funds (ETFs) are an obvious investment alternative that give you the diversity of a mutual fund at a much lower cost. Similar to many mutual funds, ETFs usually represent diversified portfolios of securities that track specific indices, but you buy and sell ETFs on a stock exchange instead of dealing directly with the mutual fund company itself.

A popular ETF is BlackRock's iShares S&P/TSX 60 index fund (XIU), an equity fund with \$12.5 billion of assets at December 31, 2012, and an MER of just 0.18%. In the ETF example (see chart on p. 22), the same \$100,000 investment





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would have grown to \$193,431. That is \$30,542 higher than the return on the mutual fund.

The key reason for such a significant difference is the lower MER fees. The total fees would have come to only \$2,550, which is \$23,235 less than the mutual fund. And lower fees mean better returns. The ETF's annual rate of return is not 5%, it is 6.82% — the increase being provided by the 1.82% lower MER that is then reinvested each year in the ETF.

### Low-cost option #2: GICs

Another investment that is cheaper than mutual funds is good old-fashioned guaranteed investment certificates (GICs). When you buy and hold a GIC you pay absolutely no fees. If you use an adviser to buy a GIC for you, he or she will get a commission, but that fee comes from the institution that issues the GIC, not from your pocket. In other words, GICs don't have a MER.

The knock against GICs is the low rate they currently pay. For example, a search in April showed the best annual interest rate on a five-year GIC was 2.85%, the lowest 1.4% and the average 2.13%. Obviously, there is a trade-off here. You are sacrificing potentially higher returns for a guaranteed lower rate, which is why it's so hard to find advisers who will buy GICs for your account — there is no room for them to make fees anywhere near what they can get from selling mutual funds.

### Low-cost option #3: paying down debt

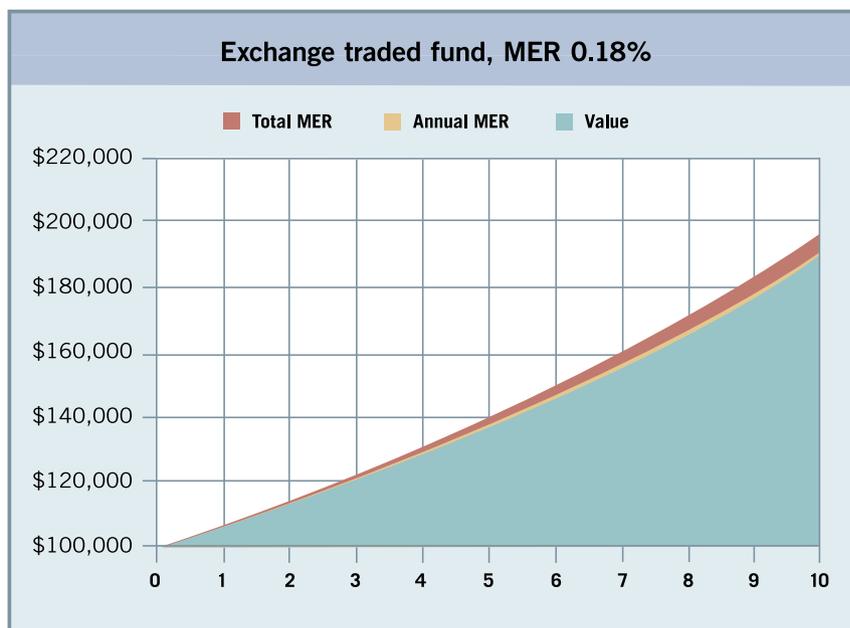
This is my favourite alternative to investing in mutual funds.

#### FEE FINDERS FOR FUNDS

If all this has got you thinking about what your own investments are costing you, check out the Investor Education Fund's mutual fund fee calculator at [www.getsmarter-aboutmoney.ca](http://www.getsmarter-aboutmoney.ca) (look under Tools & Calculators).

Simply select your fund, enter the amount invested, the number of years you plan to hold the fund and choose the type of load fee and it will calculate the estimated final investment value based on the historical performance of the fund. It will also detail the costs including sales fees, MER and redemption fees and the average annual cost (and opportunity cost) of the money lost to fees.

Information on fees and rates of return is also available on the Funds Facts document for all mutual funds. Check the fund's website or [www.sedar.com](http://www.sedar.com). —DT



Let's be honest, you can't talk about how much you have saved if you don't talk about how much you owe. It's the net savings that is key, not the market value on your investment account. Look at it this way; the absence of a cash outflow is as good as a cash inflow, and even better if that cash inflow is taxed.

Say, for example, you are paying interest on a \$20,000 loan at a rate of prime (3% at press time) plus 1%. If you pay off the debt you would save \$800 in interest each year. If you invested the money instead, and assuming you are in a 40% marginal tax bracket, you'd have to earn \$1,333 on your \$20,000 investment to leave you with \$800 after tax. That is a rate of return after all fees of 6.7%, which would be very difficult to achieve from a mutual fund on a consistent basis.

For those with higher-interest debt (such as the double-digit rates charged by many credit cards) the debt pay-down strategy becomes even more attractive. You get a guaranteed after-tax rate of return of whatever the interest rate is on your debt — and there are no fees, visible or hidden. That is tough to beat.

Canadian regulatory authorities are starting to respond to the fact that hidden mutual fund fees are not widely disclosed or understood by investors. Effective July 15, 2013, new rules are being phased in by the Canadian Securities Administrators that will require members to disclose an annual summary in dollar terms of all fees charged, including those hidden in the MER, as well as rates of return for accounts over one-, three-, five- and 10-year periods and since they were opened.

It will be very interesting to see what happens as more and more Canadians figure out that they are paying way too much for their poorly performing mutual funds. But you don't have to wait. All you have to do is stay away from mutual funds in the first place.

David Trahair ([www.trahair.com](http://www.trahair.com)), CPA, CA, is the author of five books related to personal financial issues, including his latest, *Cash Cows, Pigs and Jackpots*. He also gives seminars to accountants about his books



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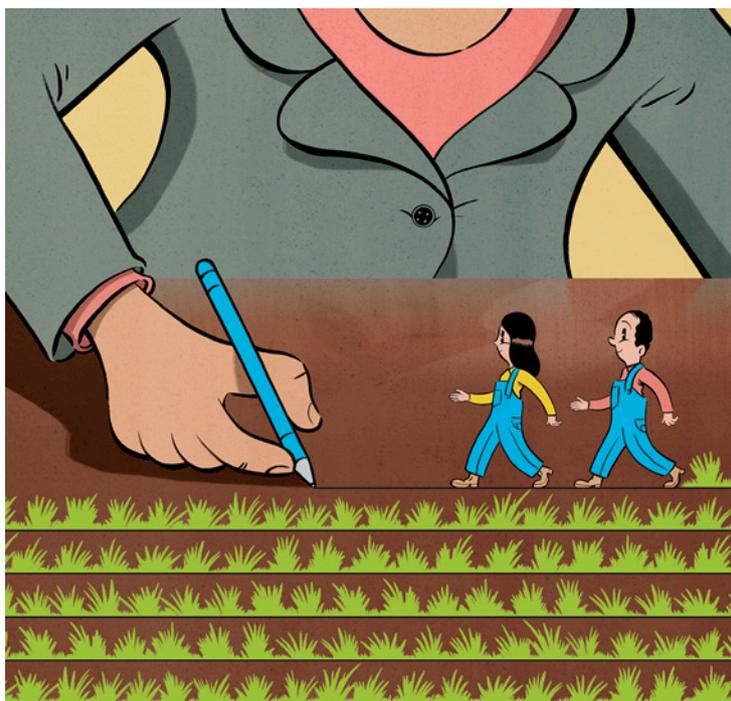
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# IT takes a TEAM

How accountants and financial planners  
can help clients forge a path to a fruitful retirement

By Luke MacLennan & Gord Hardie



**FOR MANY CLIENTS, THEIR ACCOUNTANT IS THEIR MOST TRUSTED** and valued financial service provider. They are relied on to prepare financial statements and tax returns as well as for tax and estate planning advice. However, despite having accumulated a wealth of knowledge about a client's financial and personal situation by performing these services year over year, few accountants are involved in a client's personal financial planning. As financial planning has traditionally not been a service provided by accountants, it is understandable that many are not familiar with how their skills and expertise can be utilized in the financial planning process.

illustration by RYAN SNOOK

John and Mary's net worth statement (Pre-tax values)				
	John	Mary	Subtotal	Total
<b>ASSETS:</b>				
<b>Nonregistered investments &amp; TFSA</b>				
Personal loans	0	0	0	
Investment portfolio	15,000	15,000	30,000	
Joint portfolio	111,241	111,241	222,482	252,482
<b>RRSP/RRIF &amp; pensions</b>				
RRSP/RRIF	264,979	270,406	535,385	
Defined contributions pension/LIRA	0	0	0	
Defined benefit pension	0	0	0	535,385
<b>Real estate</b>				
Principal residence	175,000	175,000	350,000	
Recreational property	0	0	0	
Commercial real estate	0	0	0	350,000
<b>Other assets</b>				
Farm assets (tax value is \$1 million)	2,000,000	2,000,000	4,000,000	
Personal use assets	30,000	30,000	60,000	4,060,000
<b>TOTAL ASSETS</b>	<b>2,533,720</b>	<b>2,539,147</b>		<b>5,072,867</b>
<b>TOTAL LIABILITIES</b>	<b>0</b>	<b>0</b>		<b>0</b>
<b>FAMILY NET WORTH</b>	<b>2,533,720</b>	<b>2,539,147</b>		<b>5,072,867</b>

But an accountant's knowledge and experience can be integrated into the financial planning process and by doing so it can benefit the client.

### IDENTIFYING THE NEED FOR FINANCIAL PLANNING

John and Mary have been clients of Charlotte, an accountant, for 15 years. Charlotte has prepared the financial statements and tax returns for their farming business, as well as personal tax returns for John, Mary and their two children.

During a recent meeting, the conversation turned to John and Mary's children. James, their eldest, had assumed many of the responsibilities in operating the farm and had expressed interest in taking over the business. As for their daughter, Brenda, since graduating from college five years ago she has been pursuing outside interests and is unsure if she wants to join the family farm. At one point John said, "I don't know how much sleep I have lost thinking about what's going to happen with the farm when we retire and what it means financially for both ourselves and our children." Hearing this, Charlotte recognized that John and Mary needed a financial plan. "What would you say if our firm could help you by producing a document that provides you a road map into your retirement and lays out all the financial details in your options for transitioning your business?" she asked the couple. Without hesitation John replied, "Where do I sign up?" Although Charlotte possessed considerable intergenerational farm transfer experience, she recognized several other factors needed the attention of a financial planner.

Charlotte explained the financial planning services available through her firm and how she would sit in on meetings with

the financial planner, Farhan. John and Mary agreed to proceed. Charlotte provided an engagement letter outlining the nature of the services and an estimate of the cost.

### GATHERING INITIAL INFORMATION

Prior to meeting John and Mary, Charlotte provided Farhan with their relevant profile information. In addition to their financial information, including past tax returns and a listing of assets they held, Charlotte shared with Farhan her knowledge of the family dynamic. This was valuable information for Farhan, as it is crucial for a financial planner to have as strong an understanding of a client as possible.

Using Charlotte's financial information, Farhan prepared a net worth statement for John and Mary (see above). He also noted the farm was not incorporated and its assets included real estate, machinery, livestock and some feed and produce.

### DISCOVERY MEETING

During the initial meeting, Charlotte assisted John and Mary in communicating to Farhan the background facts along with their wishes and concerns. Although John and Mary had a strong understanding of their finances, they took great comfort in having Charlotte in attendance to confirm the information they were providing as well as to answer any of Farhan's more technical questions.

A key objective of the discovery meeting was for Farhan to strengthen his understanding of John and Mary's current situation as well as their personal goals and objectives. During this meeting Farhan noted the following:

- John and Mary successfully operated their farming business for more than 30 years;
- both are 62 years old and want to retire in two years;
- five years ago John and Mary built a home near the farm property that will remain their home in retirement. James purchased their old farmhouse at fair market value;
- of the two children, James has expressed interest in taking over the farm, while Brenda is still undecided;
- their transition options include James taking ownership, both children taking ownership or selling the farm to an outside third party;
- John and Mary have not used any of their combined lifetime capital gain exemption limit of \$1.5 million;
- regardless how the farm is transitioned, John and Mary want to ensure both children are treated fairly financially;
- in the event one or both children take over the farm, John and Mary want to ensure there is an arrangement allowing them to be financially independent in their retirement, while at the same time not burdening their children with financial obligations that would hinder their ability to operate the farm; and
- James has been married four years and Brenda is engaged. John and Mary have concerns about what would happen to the ownership of the family business in the event of a marriage breakdown.

Since Charlotte knew John and Mary were not frivolous spenders, she suggested Farhan walk them through a forced cash flow analysis (as illustrated below) rather than doing an in-depth analysis of their after-tax cash needs. Using the financial information provided and asking straightforward questions, Farhan was able to quickly determine John and Mary's after-tax cash needs. By starting with their personal income and deducting amounts for taxes, savings and other expenditures it was determined their apparent annual after-tax lifestyle need, the amount required to pay all their costs of living, including discretionary spending, is \$75,000. By using this simple, easy-to-follow chart John and Mary understood what Farhan was showing them, and by hav-

ing Charlotte involved, they were all confident in the numbers.

After taking John and Mary through his discovery meeting questions, Farhan prepared the following summary of their financial goals:

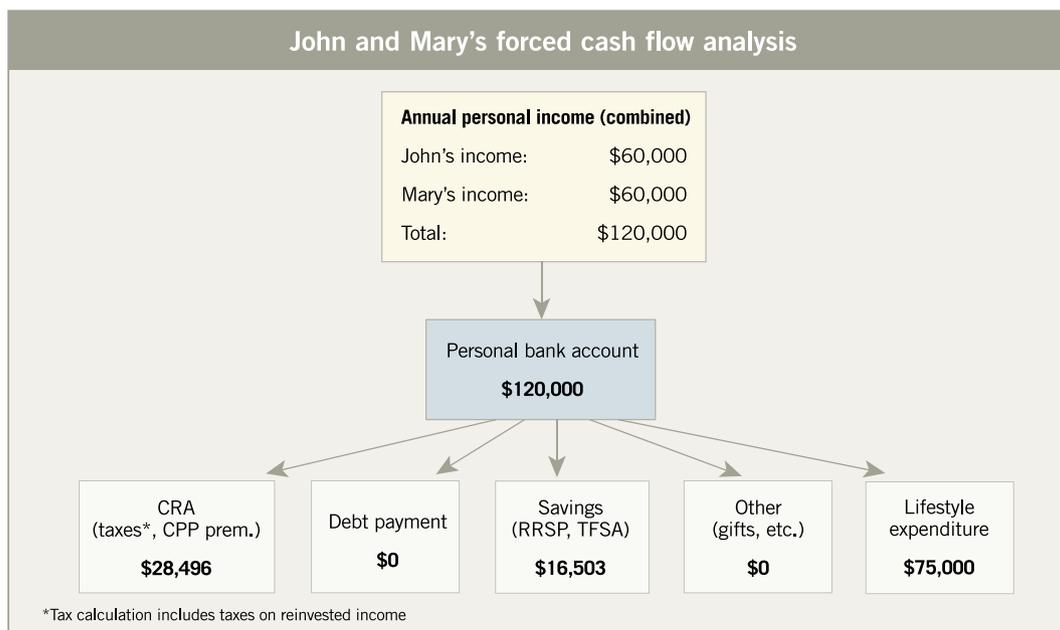
- full retirement for both on July 1, 2015, with an annual after-tax income need of \$75,000 in today's dollars, indexed to inflation;
- minimize tax on income and maximize an after-tax estate for beneficiaries;
- assess whether some or all the value of the farm is needed to meet retirement needs and balance this with a possible transfer of the farm to one or both children. In addition, if only James were to receive the farm, what might be the best way to treat both children in a fair manner while minimizing taxes; and
- establish a tax- and cost-efficient portfolio asset mix that meets their risk comfort level while generating adequate returns to fund retirement.

John and Mary were delighted with Farhan's list of objectives and thanks to Charlotte's involvement they were confident all key issues were being addressed. By giving her input during the initial discussion, Charlotte was confident John and Mary would be provided analysis and recommendations customized to their goals and situation.

Next, Farhan began working on John and Mary's financial plan, consulting with Charlotte regularly, especially on items related to tax planning.

## RETIREMENT INCOME PROJECTION

Farhan's first step was to determine if it would be possible for the couple to meet its cash flow needs throughout retirement without receiving cash from the farm assets. To perform this analysis Farhan needed to make assumptions regarding Mary and John's available nonfarming business capital at retirement (based on savings and investment returns until retirement it was estimated to be \$923,396), inflation rates (with 2% inflation, their lifestyle needs will be \$78,300 at retirement), life expectan-



Retirement income analysis							
	Investment assets			Lifestyle goal		Investment savings	
<b>Available capital</b>	<b>923,396</b>						
<b>Lifestyle goal</b>				<b>78,030</b>			
<b>Current savings</b>						<b>16,503</b>	
	Weighted return*	Required capital	Excess (shortfall)	Required lifestyle	Excess (shortfall)	Required savings	Excess (shortfall)
<b>Conservative</b>	3%	1,361,149	-437,752	55,812	-22,218	163,736	-147,233
<b>Moderate</b>	5%	1,044,024	-120,628	70,527	-7,503	47,375	-30,872
<b>Aggressive</b>	7%	823,070	100,326	85,446	7,416	-32,458	48,961

\*The weighted return is for illustration purposes only; it is not intended as an estimate or guarantee of future performance

cies (estimated at 90 years of age) and a range of investment rates of return. (Farhan's findings are shown above.) In calculating John and Mary's income projection, Farhan included investment returns, drawing down capital and amounts received from Canada Pension Plan and Old Age Security.

Farhan's retirement income projection for John and Mary illustrates they are able to meet their after-tax lifestyle goal without using the farm assets only if their investments are held in aggressive portfolios, capable of yielding an annual return of 7%. In Farhan's view, a 7% income requirement is uncomfortably high for a retirement income portfolio, since it requires a higher level of equity investments.

As a result of this analysis, Farhan concluded generating cash flows from the farm business would be a requirement in John and Mary's plan.

## OPTIONS FOR TRANSITIONING THE FARM

To address John and Mary's need for cash flow from farming assets, Farhan looked at options related to transitioning their business. His recommendations for transferring the farm business to the children include two possible scenarios.

### SCENARIO 1: transfer to both children

The farming assets should be transferred using the following methods:

**Inventory:** feed, produce and livestock should be transferred in exchange for an "open note" that is considered accounts receivable for John and Mary. Since the farm business reports taxable income using the cash method, there will be no tax consequence on the transfer of inventory until an amount is paid, at which time it would be treated as income for John and Mary.

**Capital assets:** equipment and buildings should be transferred at their undepreciated capital cost amounts to avoid triggering any recapture of depreciation for John and Mary. The farmland may be transferred at any amount between cost and fair market value. To use John and Mary's combined capital gains exemption the transfer value of the land is set at \$1.5 million above its cost.

As compensation for the transfers, John and Mary should receive promissory notes of \$2.5 million — the tax value of the farm assets plus the \$1.5 million in excess of the cost of the land. The notes should provide that up to one-tenth of the principal is repayable in any year. This will allow them to claim a reserve, spreading the reporting of capital gain on the land over 10 years.

This will serve to eliminate any alternative minimum tax, and reduce the impact of any OAS clawback.

For tax purposes, the difference between the \$4-million fair market value of the farm assets and the \$2.5-million promissory notes is considered a \$1.5-million gift from John and Mary to their children.

There are two reasons for transferring the land at a higher amount:

- the children benefit from a higher adjusted cost base, which could result in less tax when they eventually sell the farm; and
- it creates larger amounts owing by their children, which will reduce the net family property of James or Brenda in the event of a marital breakdown.

The part of the transfer of assets that is considered a gift can, in the case of James, be excluded from his net family property under the Ontario Family Law Act, as it is a gift while he is married. John and Mary could wait until Brenda is married to transfer her share of the farming business to accomplish the same result.

One of the notes should be for \$550,000 (retirement fund note), the amount of capital they are short to fund their retirement based on the 3% return scenario illustrated in the chart above, plus a little more than \$100,000 for capital expenditures — such as vehicles. An arrangement with the children should be established for the repayment of this note throughout John and Mary's retirement to supplement their income. The other note for the remaining balance of \$1,950,000 would be forgiven in John's and Mary's wills, along with any remaining balance of the retirement fund note.

### SCENARIO 2: transfer business to James

In the event Brenda decides not to receive ownership of the farm, the transfer methods outlined in the first scenario will still apply to the transfer to James.

Along with the \$550,000 retirement fund note two additional notes are issued for the balance of \$1,950,000. One of these notes will be used to transition John and Mary's wealth to James and would be forgiven in their wills (James' note) while Brenda will receive payment of the other note (Brenda's note). Brenda's note will need terms stipulating security, interest rate and payment schedule that James would honour upon the last to die of John and Mary. Satisfying John and Mary's objective of both children being treated fairly is accomplished through the value of Brenda's note. Where Brenda's note is \$1.725 million, James' note of \$225,000

## John and Mary's investment portfolio summary

Account	Cash	Income producing			Equity			Total
	Cash & equiv.	Bonds: Cdn	Bonds: foreign	Pref. shares	Canadian	US equity	foreign	
<b>REGISTERED PLANS</b>								
John RRSP	\$4,871	\$50,211	\$16,564	\$5,053	\$73,769	\$72,298	\$42,213	\$264,979
John TFSA	\$15,000	\$0	\$0	\$0	\$0	\$0	\$0	\$15,000
Mary RRSP	\$7,368	\$50,774	\$821	\$0	\$147,157	\$30,283	\$34,003	\$270,406
Mary TFSA	\$15,000	\$0	\$0	\$0	\$0	\$0	\$0	\$15,000
<b>TOTAL REGISTERED</b>	<b>\$42,239</b>	<b>\$100,985</b>	<b>\$17,385</b>	<b>\$5,053</b>	<b>\$220,926</b>	<b>\$102,581</b>	<b>\$76,216</b>	<b>\$565,385</b>
Asset allocation	7%	18%	3%	1%	39%	18%	13%	100%
<b>NONREGISTERED</b>								
Joint account	\$2,529	\$124,140	\$496	\$0	\$75,395	\$13,903	\$6,019	\$222,482
<b>TOTAL NONREGISTERED</b>	<b>\$2,529</b>	<b>\$124,140</b>	<b>\$496</b>	<b>\$0</b>	<b>\$75,395</b>	<b>\$13,903</b>	<b>\$6,019</b>	<b>\$222,482</b>
Asset allocation	1%	56%	0%	0%	34%	6%	3%	100%
<b>TOTAL PORTFOLIO</b>	<b>\$44,768</b>	<b>\$225,125</b>	<b>\$17,881</b>	<b>\$5,053</b>	<b>\$296,321</b>	<b>\$116,484</b>	<b>\$82,235</b>	<b>\$787,867</b>
Asset allocation	6%	29%	2%	1%	38%	15%	10%	100%

plus his gift amount of \$1.5 million will equal Brenda's note. Any balance of the retirement fund note would not be forgiven in the wills. However, business risk assumed by James, annual incomes and inflation amongst other factors should be considered to determine what John and Mary feel is fair.

To offset this future cash outflow James could take out a permanent joint-last-to-die insurance policy on John and Mary with an insurance amount of \$1.725 million — the amount that will be owed to Brenda. On the death of the survivor of John and Mary, James would use the insurance proceeds to pay Brenda.

Other options related to James paying Brenda include setting up a sinking fund and making scheduled contributions. The fund would eventually be used to settle a portion or all of the debt. Alternatively, James can arrange financing secured by the equity in the farm to pay the amount owed to Brenda.

James can also use his share of the nonfarming assets he inherits, such as John and Mary's house, to settle a portion of his debt with Brenda.

### CURRENT INVESTMENT PORTFOLIO

As investment management is a key component of the financial plan, Farhan reviewed John and Mary's current investment portfolio (see table above).

Farhan's observations include:

- portfolio mix is 37% cash, bonds and preferred shares and 63% equities. This could be considered a moderate- to high-risk portfolio, perhaps too aggressive for their retirement years;
- holding 6% of their portfolio in cash is decreasing their yield (\$10,000 in bank accounts provides sufficient liquidity);
- holding bonds in nonregistered accounts and Canadian equities in their registered accounts is creating tax inefficiencies; and
- portfolio is primarily mutual funds. A discretionary portfolio management offering could reduce fees and potentially bet-

ter meet their investment objectives. A discretionary portfolio manager could also work with John and Mary to determine a suitable portfolio mix.

Farhan estimated annual savings from addressing these issues to be more than \$9,000 a year, more than 1% of their portfolio.

### PLAN REVIEW

To ensure his analysis and recommendations were as customized as possible, Farhan gave a copy of the plan to Charlotte for review. She went over each section, ensuring all information was consistent with her understanding of John and Mary's situation. She also carefully reviewed the technical aspects of the recommendations, ensuring they were consistent with her tax knowledge and the guidance she provided Farhan as he worked on the plan.

### PLAN PRESENTATION

Farhan and Charlotte met with John and Mary to summarize the findings of the plan.

It was a lot of information to absorb, but John and Mary felt a sense of relief knowing they now had a financial road map for their retirement years and important information that would guide decisions in transferring their farm assets.

Charlotte was proud of what had been achieved through this process. By integrating Farhan's ability as a financial planner to determine John and Mary's financial needs in retirement with her tax knowledge, her clients now had a strategy for achieving their goals and objectives. She looked forward to leading John and Mary in the implementation of their financial plan.

Luke MacLennan, CPA, CA, and Gord Hardie, CFP, are with the Independent Accountants' Investment Counsel Inc., an Ontario-based firm that works with accounting firms to provide integrated financial planning and investment management services

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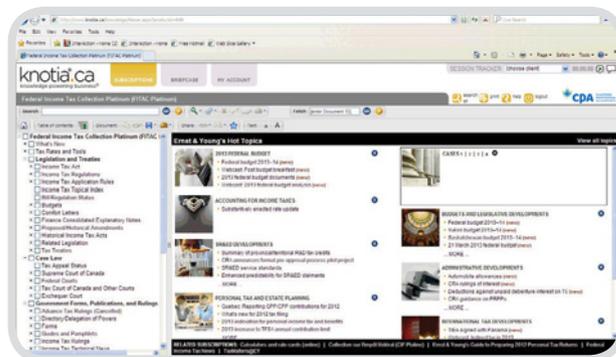
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When your clients can't get past the mumbo jumbo it's time to call in reinforcements — one wealth manager's firsthand case study

By Paul Tyers

# WEALTH taken care of

**MOST ADVISERS** in the accounting/tax/financial world find the financial concepts easy to understand and to discuss. Their private business clients are wired just the opposite to their financial advisers and don't easily understand or relate to the same logic. Their decision-making is more often a process of feelings

and intuition, which has served them well, and they aren't likely to abandon this decision-making process when transitioning business and overall wealth.

"I believe wealth management services will become the highest value services that professional accountants provide to their clients," Robert Bunting, CPA, former chair of the AICPA, stated in a speech shortly after the depths of the global financial crisis. From the perspective of private business and professional clients Bunting's vision may have come to pass. However, these services still require the support



illustration by RYAN SNOOK

of a diverse team of professionals working together, ideally in a highly coordinated manner. Furthermore, because these services are not “mandated” it may require different skills to, dare we say, “sell” them to clients. This is where different team members come in. The following is a firsthand case study of a wealth transition, based on a real situation, revised to protect confidentiality.

### **The family**

This family’s wealth was born out of the need to make a living after arriving in Canada with only the clothes on their backs. These humble beginnings have grown to a current value of \$40-million-plus in net worth, mostly in real estate in a medium-size Ontario city. A review of the corporate records tells a story in itself, one of a myriad of deals done to put together and hold together several business ventures — some of which worked and others that didn’t. Needless to say this family’s wealth was the outcome of hard work and persistence.

### **Initial involvement**

We got involved in this family situation through one son (four children in the second generation and seven in the third), the sibling most directly involved in the family business. We had helped to sort out his personal financial affairs, much of which was in disarray due to his focus on the business. We had devel-

oped a personal financial plan for him, his wife and children and were managing his investments on a discretionary basis and had also reviewed and reworked his insurance portfolio. However, while we had discussed his personal affairs in depth, we had only touched on the primary wealth of our client — his share of the family business.

### **Problem identified**

What led to our involvement was our client receiving and sharing the most recent version of a tax memo from the family business’s accountants. It spelled out in minute detail the numbers, holding companies and share structures as well as the various sections of the tax act and other corporate legal precedents. It was comprehensive and clearly created by a skilled tax professional. There was only one problem: little had progressed in two years other than meetings called by the tax professionals to ensure the family understood what was proposed. I attended one of these meetings and observed the four siblings. The patriarch and matriarch were not at this meeting, although they had attended prior succession meetings. After hearing the various family members’ perspectives, it became clear that further progress would be impossible without a different approach.

At the end of our meeting I asked if I could meet with the parents at their home. Grudgingly the tax professional and the family let the meeting proceed — with one of the daughters joining us.

## **THE 10 Ps OF SUCCESSFUL WEALTH TRANSITION**

### **Purpose**

Ensure there is a purpose for the wealth so it can connect the family. Check that both generations have an understanding of the types of assets and why each is important to the transition.

### **Principles**

Identify and share the beliefs and values that are important to uphold. This is the foundation for creating a “we focus.”

### **Philosophy**

Clarify what you want to achieve and the family legacy that you want to bestow. How should wealth be deployed going forward? This would include the vision for the future wealth protection and preservation, tax management, reinvestment or distribution, ongoing entrepreneurship, etc.

### **Participation**

Engage all stakeholders in developing the purpose, principles and philosophy to get different viewpoints and find the common interest.

### **Philanthropy**

Use this medium to test how stakeholders can work together and make financial decisions. See if you can create a sense of collective ownership among the next-generation beneficiaries.

### **Places to talk**

Establish appropriate forums to enhance communication and build trust. Might include a family trust meeting, a wealth management advisory board and/or a family council.

### **Policies**

Determine authority, responsibility and accountability around the future wealth distribution or reinvestment, individual compensation and financial independence and or family ethics.

### **Plans**

Create instructions for the implementation of the wealth transition and ongoing wealth management. Might include estate plans, continuity plan, family-participation plan, compensation plans and shareholder or other agreements.

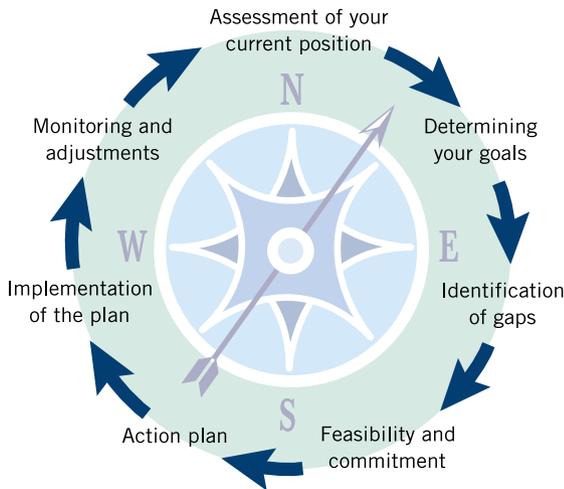
### **Processes**

Formalize the process to develop a wealth transition plan, groom heirs and nurture entrepreneurship. Begin with a strategy session. Might ultimately require a family office.

### **Passion**

Use the above steps to develop the sincerity, sense of purpose, stewardship and trust that will guide the next-generation wealth managers. — PT

## Steps to wealth transition



### Different approach

At this meeting, the stage was set for a different outcome. As this was our first meeting, I asked them to tell me what brought them to this point in their lives. And, for the next two hours they told me the important events in their lives from their beginnings in the Czech Republic, to the loss of their family wealth, to their arrival in Canada, birth of their children (and death of one), their love for their grandchildren and hope for their futures. At times there were tears, at times laughter as they recalled important events in their lives. Other than a few clarifying questions, I did not say much.

Requesting their story is a strategic step, as described in *Your Client's Story*, by Scott West and Mitch Anthony. They know their story up to this point in their lives; however, they don't know the future — where most advisers want to focus. Another important element of their story is the belief system that led to their success. These beliefs were summarized in such quotes as “we worked hard so our kids would have opportunities we didn't; we never smoked or drank; work was our vice; God blessed us; Canada is a great place for those who want to work hard.”

When I asked why they hadn't moved forward on their estate freeze they could not really remember the tax memo, but when reminded the patriarch said, “Too much mumbo jumbo. My wife and I just want everything to go to my children and grandchil-

dren, without too much tax. Our old accountant understood us, we trusted him and he just took care of things for us, but since he retired now everything is more complicated.”

### Permission to proceed

I asked if they wanted me to take care of this for their family, which would require coordinating the various professionals and family members to make sure this happened as soon as possible. I'll never forget his response: “Absolutely — we found someone again who understands us.”

Within the next two days we had an engagement letter signed, spelling out our firm's coordination role, the right to access information from all their professional advisers (accountants, lawyer, investment adviser, insurance agent, banker) and to share it between these professionals as we saw fit. Naturally, our fees were spelled out; not on an hourly basis, but on a project basis, which the father agreed to without hesitation, including 50% of the first stage of fees paid in advance. When we quantified our phase one fees the matriarch said, “That's a lot of money; in fact more than we paid for a few of our houses, but I can see it's not expensive in relation to what is at stake. We are going to make sure that our kids know how much this is costing and that they better cooperate and get this done.”

### Difference in the approach

To understand what was important to them and establish trust and empathy, I first had to learn their story. Second, we had to communicate in terms the key stakeholders understood and could relate to; this did not include citing sections of the Income Tax Act. Third, we needed a process that communicated in simple terms the steps to take now and in the future.

The chart, above left, depicts the high-level steps we follow in our wealth transition process. Within each step are pictorial tools that have proven successful in communicating to our typically right-brained clients the steps we are taking and why.

### Sense for clients and firms?

My experience over the past 10 years of integrating wealth advisory services with accounting firms is that a team is required to help affluent clients with their wealth management needs. If this team is coordinated to work in sync with a defined process it can deliver the best value to clients while developing a profitable wealth management division within an accounting

firm. Since wealth management services are highly valued by clients and are typically provided on a fee as a percentage of client assets, the fees that accrue to this division generally provide greater profitability than traditional compliance services. Accounting firms need to ensure they are compliant with their provincial institute regulations, as it can be easy to cross the line — inadvertently.

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### Key accomplishments in case study

Accomplishments	Team participants
Estate freeze completed	Accounting firm, valuator, law firm
Tax liability established at death and “funded” by life insurance	Accounting firm, insurance agent
Family business philosophy defined and who would be running the business	Business-transition adviser
Portfolio assets consolidated and managed	Portfolio manager, accounting firm (for ongoing tax minimization)

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## Victims of fraud

Scams can destroy their prey financially, physically and emotionally. So forensic accountants need to deal with victims on a human level

In July 2009, an invisible bomb exploded in the lives of more than 200 people. That's how Joey Davis, a member of the Earl Jones Victims Organizing committee began his presentation to a parliamentary committee considering Bill C-52 (Retribution on Behalf of Victims of White Collar Crime Act). "In the first week of July, Earl Jones, this seemingly charming and erudite man, had locked the front door of his West Island business office, did not return phone calls or emails from worried clients, and went missing for nearly three weeks. This left a feeling of panic and confusion amongst all his former clients."

Davis was referring, of course, to a man who became known as Canada's Bernie Madoff. Jones, a Montreal investor, had defrauded friends and family out of \$50 million in a Ponzi scheme that, as inevitably occurs, eventually collapsed. When the 67-year-old was sentenced to 11 years in prison in 2010, his brother, Bevan, who was taken for more than \$1 million, yelled out in court: "You can rot in hell!"

Although Jones was given more than a decade behind bars, it's unlikely he will do much rotting behind bars. Under the sentencing guidelines at the time, he was eligible for parole in two years.

Many of his victims, however, face a far longer and, in some ways, harsher punishment. As fraud investigators, it is important to understand, as best we can, how fraud can impact those who fall prey to financial schemes. This can be especially helpful when interviewing victims during an investigation.

"Of the noted 185 creditors of the Earl Jones bankruptcy, those aged 50-plus and seniors comprise approximately 90% of the Earl Jones client registry," Davis told the committee. "The financial as well as the emotional trauma suffered by these victims affects three generations within the family structure. These are the investors themselves, typically the grandparents who have lost all of their life savings; the adult children of the investors, who are now left to financially support their parents; and the children and grandchildren of the investors, whose inheritance and financial security have been stolen from them."

Although victims come in all ages, Davis' comments



SARA TYSON

can remind us that in many cases the ripple effects of a fraud can be significant.

In the past, fraud was often labelled a victimless crime. In fact, victims were often considered to be dupes who allowed themselves to be fleeced by smarter people, dubbed con artists. It's hard to imagine such a positive description being attached to murderers, armed robbers or kidnappers (homicidal artists). If the fraud victims had fallen for tempting promises of inflated returns — the *modus operandi* of Ponzi schemers — their ultimate financial losses were often seen as a just consequence for their greedy pursuit of quick and easy money.

Even the term “white-collar crime” has a tone of civility to it. The first mention of the phrase is attributed to US sociologist and criminologist Edwin Sutherland in a 1939 speech entitled “The white-collar criminal,” which he presented to the American Sociological Society. Sutherland defined fraud and its ilk as a “crime committed by a person of respectability and high social status in the course of his occupation.” It almost sounds like an excuse rather than an accusation.

Fortunately, those skewed perceptions are rarely espoused anymore. The FBI, on its website, states that fraud “is not a victimless crime. A single scam can destroy a company, devastate families by wiping out their life savings, or cost investors billions of dollars [or even all three, as in the Enron case].”

The authors of a 2012 article in *Security Journal*, Mark Button, Chris Lewis and Jacki Tapley, echoed this point. They conducted interviews with more than 800 people in England and Wales “to explore the impact of fraud on victims.” They discovered a wide variation in reactions with some victims “reporting little or no impact of fraud whereas others clearly suffer devastating impacts. This destroys the myth of fraud being almost entirely a victimless crime or a crime of lesser impact.”

Some victims, they wrote, “actually feel like they have been raped.” This connection was also made by M. E. Walsh and D. D. Schram in a 1980 article, “Victims of white-collar crime: accuser or accused?” They note, “Both victims of rape and white-collar crime are often viewed with a mixture of skepticism, suspicion and disbelief. Such perspectives generally stem from the views that victimization from fraud and rape happens only to those of questionable character and to those who disregard the simple rules of conduct. Just as public attitudes toward the rape victim stimulate guilt and shame in the victim, so victims of fraud are frequently ashamed or embarrassed by their conduct.”

In a presentencing letter to fed-

eral district court in lower Manhattan, one of the victims of Madoff's US\$65-billion fraud said he and his family “were raped [and Madoff] should be treated no differently than any rapist.” Richard B. Shapiro, who lost his life savings in the fraud, said he was now penniless. After learning he'd been defrauded, he went into a deep depression, didn't leave his house for a month and lost 30 pounds at the thought of him and his family becoming homeless. “I had no desire to live, no prospects of earning a living, no way to pay the bills,” he wrote.

The authors of the *Security Journal* article found, understandably, that the most obvious consequence for victims is the financial loss, which can have varying effects from those experienced by Shapiro to far less onerous ones. “For some ... such is the loss that it results in them having to sell assets [often their home], or to go back to work [if they were retired], unable to secure credit or in the worst case sometimes they even become bankrupt. The impact of fraud can also lead to a range of health problems, both physical and mental. A study of victims of a Ponzi scheme found many were afflicted with depression as a consequence ... [and] that some of the victims of the [media baron Robert] Maxwell pension fraud felt their husbands' deaths were accelerated as a result of the scam.”

An interesting side note, the authors add, is the breakup of marriages and relationships due to “loss of wealth and sometimes the way in which the money has been lost [often hidden from part-



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ners]. Examples reported to us are cases of scams and the effect on chronic victims that when family members try to intervene to stop them it leads to a disintegration of their relationships.”

Some victims report symptoms that mimic those associated with post-traumatic stress disorder (PTSD), according to wjfa.net, a website whose slogan is “Help for fraud victims.” A 2011 posting stated, “PTSD for fraud victims is real. Many fraud victims during the past decade say the legal battle or prosecution is a big trigger. We’ve had people telling us they don’t understand why they get anxious and want to flee when near a courthouse.”

Such information can be of considerable value to fraud investigators when dealing with victims. It helps them sense how to conduct interviews with victims who might be displaying classic PTSD symptoms. For example, one symptom is the need to go over what happened in very specific detail. And that can be irritating and exasperating for the interviewer. However, if the victim is suffering from some degree of PTSD, then it’s likely the interviewer will be more sympathetic and might also be able to advise the victim to seek assistance from a professional counselor.

The inability to sleep through the night is another PTSD symptom, as is sudden rage, often over minor occurrences, and uncontrollable sobbing. It is always important, of course, not to play amateur psychologist. But it’s beneficial to be aware that some victims could be undergoing more than just the normal range of emotions common to most victims.

Knowing that the prospect of going to discovery or trial can be a trigger for some victims (likely a small number) can help investigators decide the best way to handle a witness who might be experiencing this type of reaction.

While sensitivity to the devastating effects that being defrauded can have on some victims is unquestionably a positive thing, it’s also important to know that it’s likely a small minority who suffer such an extreme reaction. In a 2012 *Psychology Today* article, “Abusing the term trauma,” David J. Ley, PhD, cautions that trauma and PTSD may be overdiagnosed. “The experiences which create PTSD are traumatic experiences in which there was an actual risk to life and physical integrity,” he says. The latter can certainly happen to some fraud victims, especially those who believe their life has been destroyed. Most, however, suffer some psychological wounds of a lesser intensity.

There is another form of stress some victims deal with, one that rarely existed in past decades when fraud cases rarely made the news: dealing with the media. Until recently, fraud was underreported. Then along came names ordinary citizens would normally never have heard of, such as Enron, WorldCom and Tyco. Fraud was suddenly in the headlines and on the TV news.

In the article “Dealing with media intrusion,” published by a UK and Wales charity called Victim Support, it’s noted that “victims of crime can often find themselves suddenly the centre of attention for the media. Sometimes this can be helpful — for example if it helps catch criminals or helps others avoid becoming a victim. But victims can also find the attention of journalists intrusive and upsetting.”

Victim Support recommends that victims “get advice before saying anything to journalists ... once a journalist has reported something you have said, it’s very hard to stop it being repeated across lots of other media. Think very carefully about what you want to say, if anything. Your comments could follow you around for a long time.” It points out, however, that some victims find it helpful to talk to the media. “It allows them to get their feelings off their chest. It also gives them an opportunity to warn other people of the risks or to draw attention to how they coped or to thank people who helped them.”

At the same time, victims need to know they are under no obligation to tell their story or to enter into some arrangement with a media outlet. A victim might ask a forensic accountant for advice on whether to speak with a journalist. If the investigator is experienced in dealing with the media then any advice might be helpful. If not, it’s best to refer the victim to someone who knows how the media works.

No matter the details of a fraud, its victims will almost certainly need to find some way to help them heal from the financial, psychological and, for some, physical effects the crime has had on them. It will likely be different in every case.

## **“PTSD for fraud victims is real. Many victims say the legal battle is a big trigger. We’ve had people tell us they don’t understand why they get anxious when near a courthouse”**

After author Geneen Roth learned Madoff had stolen her life savings, she wrote *Lost and Found: One Woman’s Story of Losing Her Money and Finding Her Life*. “In this moment, when I began paying attention to what I did have instead of what I didn’t, there was a constant, unavoidable display of gorgeousness everywhere, anywhere,” she wrote. “In this exact moment, in the kitchen or backyard or car, there was no catastrophe.”

Jones’ victim Mary Coughlan told the Montreal *Gazette* that once she knew her money had vanished, she would wake up at 4 a.m. “feeling sick with dread.” Then she read *The Sociopath Next Door* by clinical psychologist Martha Stout. “Coughlan was so transformed by what she read she bought eight more copies and handed them around to other victims,” the *Gazette* reported.

“The book got me over the anger and I realized the kind of man he was. He didn’t care about my anger, so I stopped fretting about it,” Coughlan told the paper. “I suddenly realized where [Jones] is coming from. The man had no conscience, and nothing could be done to make him different.”

It’s interesting to see how some people cope with the aftermath of a fraud. Although the investigation is a forensic accountant’s most important task, we might also have to counsel someone going through shock. Just as doctors need a bedside manner, we too need to know how to deal with victims on a human level.

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

## To change or not?

Has the time come to change the auditor's report to develop a different grading system and increase the value of auditing to society?



**R**egulatory attempts to improve the functioning of capital markets often try to make corporate activities more transparent. The International Auditing and Assurance Standards Board (IAASB) invited comments on its proposals contained in “Improving the Auditors Report,” with an exposure draft expected to be issued by June. These proposals are intended to make the audit report more useful, and to better communicate the role of auditors. Auditors’ boilerplate, essentially pass/fail, reports reveal little of the fine-grained understanding they gain about the inner workings of their clients, including internal controls, accounting policies, disclosure and governance.

The IAASB proposes to replace the current three-paragraph standard by a new four-page report that will add two new elements: an opinion about management’s use of the going concern assumption and an auditor commentary. The rationale for this five- or six-fold expansion under the proposal is that the commentary should help users better understand the audited financial statements and the audit. A sample report in the proposal includes comments on litigation, goodwill, financial instruments, and audit strategy for verifying revenue, receivables and cash receipts, the entity’s internal control over these items, involvement of other auditors, responsibilities of management and responsibilities of the auditor.

Repeated burials do not seem to prevent some bad ideas for audit regulation from being resurrected periodically.

SUSANNA DENTI

Auditor opinion on the going concern and financial viability of a company is one of these zombies. The going concern assumption already undergirds a clean audit report, which cannot be issued if the auditor has any doubts. Beyond that, the auditor has no special insight on the future viability of a company. Requiring further opinion from auditors will either induce them to wait until doubts about the continued viability of the firm become common knowledge or issue advance warning about such doubts. The former is worthless because by then the horse would have escaped the proverbial barn. The latter will likely prove to be a self-fulfilling prophecy and cause the client to fail. Either way, this part of the proposal does little to improve auditing or financial reports.

The major substantive proposal for an auditor commentary will revive the early practice of a detailed oral report (giving rise to the term “auditor”), subsequently changed to writing. Before being regulated under the 1932 and 1933 US securities laws, auditors issued either a short-form or a long-form report. Short-form reports could be a single word (e.g., Certified) or one sentence (I Certify the above statement is correct).<sup>1</sup> Long-form audit reports provided more nuanced and informative commentary about the procedures performed and valuation judgments made by the auditor. For example, the 1902 Price Waterhouse audit report for US Steel commented on policies on fixed-asset capitalization, depreciation, inventory valuation and revenue recognition and described in detail audit procedures conducted to verify cash.<sup>2</sup>

IAASB’s sample audit report resembles this early PW report by including auditor comments on appropriateness of accounting policies, subjectivity inherent in applying these policies, internal control and description of audit procedures conducted to verify accounts pertaining to key risk areas. But it differs in one crucial respect: IAASB seeks to mandate for all what PW and US Steel chose to do on their own more than a century ago.

In an unregulated audit market, variability of reports enabled investors and directors to learn useful information about a specific company. However, with the introduction of regulatory mandates, audit reports are stuffed chockful of boilerplate “disclosures” that disclose nothing, burying any nuggets that might be important and newsworthy. It would be good news if, through IAASB’s new proposal, the regulators were trying to recapture the informativeness and the sense of responsibility that even a single word report (e.g., “Certified”) conveyed to the reader of financial reports before the advent of regulation. This is unlikely, because the long auditor commentary simply furnishes more pages of boilerplate fine print to bury any salient issues that may deserve the attention of the readers. Perhaps a better understanding of the forces behind the tendency to move from short but informative to long boilerplate jargon-filled reports may help forestall this development.

One possibility is that audit regulation has replaced a value-to-customer attitude in the audit profession by a comply-with-the-rules attitude. Studies by Jamal and Sunder<sup>3,4</sup> of certification reports show that government agencies tend to issue pass/fail certification reports (for everything from elevators to restaurant

cleanliness) whereas private-sector certification agencies such as *Consumer Reports* tend to offer more finely graded reports on five-, 10- or even 100-point scales, sometimes with subgrades for specific features of the product or service (e.g., value, comfort, gas mileage, safety and maintainability of a car). Introduction of regulation of auditing plausibly pushed the practice toward a compliance mentality encouraging issuance of pass/fail boilerplate reports.

Can regulators shift audit reports from government type to private-sector type? Existing precedents suggest it is achievable. For example, in a recent experiment, California changed its pass/fail system for grading restaurant hygiene to an A, B, C, F system, and the grade had to be posted for all customers to see. Jin and Leslie<sup>5</sup> found that this change led to significant changes in restaurant sales, as well as a drop in food-related illnesses and doctor visits. It appears the use of a finer grading system helped improve the inspection process, restaurant hygiene, consumer discrimination and public health. The SOX 404 reports on internal control also have an element of finer reporting by requiring the auditor to make assessments of deficiencies, significant deficiencies and material weaknesses in internal control and to report them accordingly.

Whether similar gains can be achieved in auditing depends

## **With the introduction of regulatory mandates, audit reports are stuffed chockful of boilerplate “disclosures” that disclose nothing, burying any nuggets that might be important**

on IAASB’s attitude and care in designing and directing the new system toward better service instead of more verbose reports for the sake of mere compliance. Our reading of the current proposal is that in its current form, it is still dominated by a compliance mentality and will likely make audit reports less, not more, useful. If the IAASB proposal was implemented in California’s restaurant inspections, instead of a big A or C, a diner would have to read four pages of framed fine print hung in dimly lit restaurant lobbies.

A second possibility is that the evolution of the audit report occurred due to shifts in the incentive structure of audit firms, such as the rise of litigation. If this is the driving force behind the rise of boilerplate audit reports, it is unlikely that regulators can turn back the clock. Requiring audit firms to provide an auditor commentary will just produce a four-page boilerplate report instead of a three-paragraph report in the hope that four pages will furnish a better defensive shield against plaintiffs’ suits in courts of law. However, if past experience is any guide, a longer report will just as likely provide additional ammunition to plaintiffs’ lawyers, no matter how carefully the words are drafted.

### **Private-sector approach to audit reporting**

As audit regulators such as IAASB have moved to harmonize practices across the globe, opportunities to learn about and identify better audit practices through international comparisons have diminished. However, we can still draw inferences about alternative reporting practices through cross-sectional comparisons of accounting and auditing with other sectors of the economy. What

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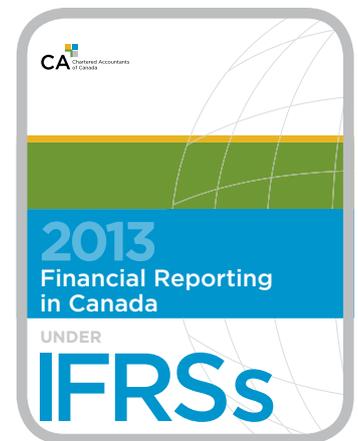


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would, or should, audit reports be in a completely unregulated market? Dubey and Geanakoplos' benchmark model<sup>6</sup> for an optimal grading system suggests three properties:

*An intermediate number of reporting grades (five or 10 possible grades)* This reporting scale is informative and motivates agents (organizations) to work hard to improve their grade. A pass/fail report is suboptimal since it is less informative and does not motivate agents to work harder. On the other hand, measurement errors vitiate excessively fine grading schemes (e.g., 100 possible grades). *A small elite grade* Making it hard to get an A allows only exceptional performers to get it, increasing the incentive for improvement.

*An absolute grading scale* Grading should be done on an absolute scale (e.g., 90-plus = A), not on a curve. An absolute scale gives all agents an incentive to exert effort to improve their grade.

Jamal and Sunder examine the availability of standards and certification for 817 goods and services in the economy. Private-sector certification is characterized by some use of pass/fail standards (e.g., Underwriters Laboratory seals on electrical appliances), but more frequent use of five-, 10-, and even 100-point scales for a wide variety of goods and services. It is common to have different experts (e.g., wine raters) trying to differentiate themselves from competitors in part by adopting a different reporting scale. Jamal and Sunder also show that new entrants in a baseball-card rating market try to differentiate their certification service by increasing the number of grades in their reporting system, providing hard-to-get elite grades and not grading on a curve.

The norm in private-certification markets is to have a choice among certification agencies that have their own proprietary standards and use different sets of reporting scales (e.g., TRUSTe versus BBB Online versus WebTrust for e-commerce privacy seals<sup>7, 8</sup>). In financial reporting this would be analogous to each of the Big Four audit firms creating their own differentiated scales for grading audit reports (just as Moody's and Standard & Poor's do for bond ratings). It is also common for private certifiers to provide more transparency by issuing subgrades and explaining how the overall grade is determined. For example, in the baseball-card certification market, Beckett Grading Service provides an overall score as well as subgrades for centring, corners, edges and surfaces.

An equivalent audit report would provide an overall grade for quality of financial reporting and subgrades for features of the financial statements and systems, such as the quality of an organization's internal control system, governance, propriety of accounting policies and quality of disclosure.

An alternative arrangement would be to create an elite reporting group of companies that agree to meet a higher standard of internal control, governance, accounting quality and disclosure (e.g., AAA-graded beef meets a higher standard, although other grades are also rated fit for human consumption). The auditor's "gold seal" issued to these companies would be available for reporting to audit committees and users of financial statements.

The current audit report does not help realize and deliver the value potential of auditing for society. While an auditor commentary has potential to be useful, it also has the risk of becoming simply more mindless and noisy verbiage under which the

real news gets buried. There is definitely a need to develop more informative audit reports to increase the value of auditing to society. More freedom to auditors and their clients in demanding and devising more informative audit reports may encourage evolution towards that goal.

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## Minimize the risks

To prevent fraud, auditors should be aware of the risk factors that come with micro-entity audits



**A**uditors are entitled to accept records and documents examined as genuine unless there is evidence they are not. This leaves primary responsibility for detecting fraud with management and those in an oversight role.

Although auditors routinely communicate their responsibilities to clients, the demarcation of roles often goes out the window the minute a fraud of any size is uncovered. This expectation gap could be called the “expectation chasm.”

In the case of micro-entities, many auditors consider the risk of not detecting fraud as significant. This is often because classic internal controls such as segregation of duties are often absent and the possibility for management override is always present. The “expectation chasm” seems very wide.

While this may be true sometimes, it’s not always the case. In fact, a number of characteristics of micro-entities can significantly reduce the risk of fraud.

Auditors should be aware of the positive characteristics as well as the perceived fraud risk factors that come with micro-entity audits. This awareness will help ensure every micro-entity audit is conducted with a level of skepticism appropriate to the circumstances of the engagement and that the audit procedures designed are effective.

A defining characteristic of a micro-entity is the small size of the management team — and that team could just be one person. The possibility of management override is ever-present.

A capable manager with a strong moral compass operating a small entity can create an environment where fraud risk is low. A less ethical manager operating in an environment with little or no oversight greatly increases the risk of fraud. This characteristic exposes micro-entities

BLAIR KELLY

to such frauds as:

- managers with sole responsibility for making changes to the payroll database or communicating changes to a third-party payroll provider being paid more than their approved salaries;
- managers taking unauthorized and undocumented advances from entities;
- relatives of management, perhaps with a different surname, on the payroll while not actively working in the organization;
- charging personal expenses to a business credit card or expense report, especially where the manager purchases items for operations that can be used personally (e.g., food, electronics, furniture);
- cash rebates from volume purchases pocketed personally;
- running fee-for-service programs for an organization and not depositing the funds into the organization's bank account; and/or
- misallocation of expenses to projects to cover insufficient spending to either mask management error or avoid repaying unspent funds.

Thankfully, there are a number of procedures that can reduce the heightened fraud risk posed by a very small management team. Specifically, fraud risk can be reduced in such situations:

- at least one member of the board of directors approves all disbursements and signs all cheques. This is only a good control if cheque signers review supporting documentation carefully;
- a detailed budget is prepared at the beginning of each year and actual results are compared to the budget with variances explained to someone in an oversight role. This assumes those in oversight are competent and understand that their role includes oversight of management;
- a competent independent bookkeeper maintains the accounting records;
- a person in oversight reviews and approves payroll reports in the same way as all other disbursements. Payroll, often the single biggest expense, is frequently not reviewed with the same care as other disbursements or not reviewed at all;
- authorizing online disbursements the same way as payments by cheque.

### Competence and capabilities of the board

The competence and capabilities of a micro-entity's board of directors can vary greatly. A board with one, or more, financially skilled member who understands the importance of a good control environment can make for strong controls over financial reporting — and dramatically reduce the opportunity for fraud.

The opposite is also true. Frauds can be missed as a result of imprudent oversight, including such situations as:

- inappropriate reliance on the manager by the board through unquestioning acceptance of management explanations and failure to review finances carefully throughout the year;
- failure to question repeated delays in producing internal financial reports and/or annual financial statements for audit. An auditor should have heightened skepticism whenever delays in

management reporting occur;

- failure of the board to insist on talking with the auditor as part of the audit process.

### Outsourcing

A micro-entity can often reduce costs by outsourcing financial tasks such as payroll, fee collection and donation processing. This can work well, provided the third parties are properly bonded and don't have direct access to the entity's assets.

However, when a third party has direct access to funds an entity is at risk. For example, third parties collecting fee revenue and processing payroll could be allowed to collect and deposit funds directly into their own accounts before sending fees on to the entity or payroll withholdings on to Revenue Canada.

Third-party fraud risk can be reduced by:

- ensuring all fees collected are deposited into a bank account controlled by the entity and do not first go into a third-party's account;
- maintaining an accounts receivable subledger and reconciling monthly deposits as if the deposits were made directly by the entity;

## **A board with at least one financially skilled member who understands the importance of a good control environment can make for strong controls over financial reporting**

- making sure payroll withdrawals are approved by management in advance and that monthly withholding remittances agree with the Canada Revenue Agency's monthly statements;
- dealing only with bonded third parties.

### Minimizing risk

So how do you minimize the risk of undetected fraud?

*Do the audit fieldwork on site* Auditors are charged with being skeptical throughout every audit, recognizing the possibility that fraud could exist. Having the engagement partner or a senior staff person perform the fieldwork on site is an excellent way to assess the quality of management and the state of the books and records.

Management's response to questions can provide firsthand evidence of management's concern or, more importantly, lack of concern for financial controls and quality of recordkeeping. In addition, the audit plan may even need revisiting if the books and records are a mess, or if management is defensive or evasive when asked questions.

*Use micro-entity appropriate audit procedures* The relatively small volume of financial records in most micro-entities lends itself to a complete overview of the general ledger and bank statements by the auditor in a short period of time. This can provide an experienced auditor with an excellent opportunity to spot unusual transactions occurring during the year.

Every audit requires incorporation of an element of unpredictability into audit procedures (CAS 240.29(c)). The unexpected

often provides insight into clients' business and accounting procedures and can result in opportunities for suggesting improvements in internal control.

Being even a bit unpredictable sends a message to a client that nothing is beyond examination.

If you audit a number of micro-entities, you might select the same unpredictable procedure for the entire upcoming season. This could include testing a number of management expense reports, verifying salary levels for all staff or reviewing some minor accounts not usually questioned.

*Communicate with a board member* Talk with the board member responsible for finances at least once during the audit and review the board minutes. This should give you an idea of the competence of the board member and the degree of scrutiny the internal financial information receives throughout the year. If the board member appears unfamiliar with finances or there is no evidence of meaningful review of financial information throughout the year, then the audit procedures should be adjusted accordingly.

*Ask if funders inspect financial transactions of specific programs* Some government funders perform detailed annual inspections of program finances. Ask management if they were inspected in the year by any third parties and, if so, ask for a copy of the inspection report.

*Ask if there are any dealings with immediate family* Dealings with family members are not uncommon in micro-entities. But the

transactions may not be either approved or at market value. Be alert for transactions outside the normal course of business and ensure that transactions with family are disclosed appropriately in the financial statements.

*Communication of potential fraud and a word of caution* Auditors must be careful not to overstep their professional role and attempt to make a legal determination that a fraud has occurred. However, it is very much the auditor's role to bring circumstances that might indicate a fraud to the attention of the appropriate person in the organization.

*Read and understand the audit standards* CAS 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements, is a gem. It is full of useful ideas and lists the minimum requirements that must be followed on every audit. The suggestions in the lists in Appendices 1 to 3 are especially helpful. Read it. You will not be wasting your time. The requirements will guide you in designing appropriate audit procedures to help you remain alert for evidence of fraud — for example, by being a little bit unpredictable every year.

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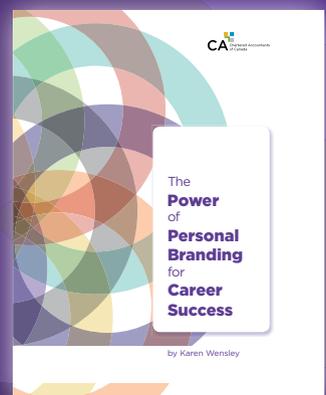
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## Not just in the schoolyard

Workplace bullies are not uncommon: at least 40% of Canadians say they have experienced harassment at their place of employment



**E**ileen had been working as a manager for a year and a half and was recently promoted to senior manager. She was thrilled to be moving up so quickly and was very proud of the hard work she had done. However, after her promotion, things changed. Her fellow associates seemed to treat her differently and the excitement she felt heading into work every day had begun to fade. Jenna and Pat, Eileen's coworkers who had been working at the manager level three years, did not seem particularly happy that Eileen had been promoted so quickly. Their unkind remarks and unwillingness to cooperate had been very discouraging, and Eileen was beginning to feel unwelcome at the office.

A few months into her promotion, things had not changed. Even though Eileen had settled into her new role, rumours spread, causing her to feel isolated from her coworkers. It seemed Jenna and Pat were trying to make her miserable. Usually easy-going and confident, Eileen found herself stressed and vulnerable.

A very determined woman, Eileen did not want to let the attitudes of two coworkers affect her life so drastically. She sought the help of a coach and together they went over several key points to help end the bullying.

### Is this uncommon?

Unfortunately, Eileen's story is not uncommon. In fact, according to the Canadian Institutes of Health Research, 40% of Canadians in the workplace experience bullying

on a weekly basis. As adults, we are campaigning to end bullying in elementary and high schools. Bullying is also an issue at work. A study conducted by the Workplace Bullying Institute (April 2012), reported that 39% of people had been bullied, 58% were currently bullied, while the remaining 3% had witnessed a bullying incident. Even if those numbers are high, clearly there is a problem. In addition, when the participants were asked if their workplace had a program in place for mistreatment of employees (separate from racial discrimination), 42.7% said no, and 26.9% said they didn't know. The following statistic, however, is the most disappointing: of the 54% of participants who reported the bullying had stopped, 78% were no longer with the same employer. So for them the bullying stopped because they left.

### Are you Eileen?

Today, it has become customary to greet each other with jokes or sarcasm, and to poke fun at each other. But how do we know when we have crossed the line? Bullying can be psychological or physical and “usually involves repeated incidents or a pattern of behaviour that is intended to intimidate, offend, degrade or humiliate a particular person or group of people,” says the Canadian Centre for Occupational Health and Safety. The key word here is “intended.”

In Eileen's case, were Jenna and Pat jealous of her quick promotion? Were they unhappy with their own positions? Was it a combination of the two? No one knows, but their intent to hurt Eileen was enough to categorize this incident as bullying.

### What to do — employees

To deal with her uncomfortable situation, the following course of action was devised for Eileen: tell Jenna and Pat that their behaviour was affecting her in a negative way and ask them to stop. Keep the conversation short. Eileen agreed to control her emotions and not to retaliate in any way. A bully is always looking for an emotional response.

Eileen practised her message before speaking to Jenna and Pat. She committed to not allowing herself to get drawn into arguments or justifications.

For example, one incident at work involved Pat addressing Eileen in a rude way in front of the entire office. It was suggested Eileen privately address Pat saying, “I would like to meet with you regarding what happened yesterday.”

It was also suggested that Eileen tell Pat exactly what behaviour concerned her and the impact it had on her; specify the changes she wants made; and mention how these changes will benefit both of them. For example, she could say, “This will create a more professional environment not only for the two of us, but for everyone else in the office. Seeing a coworker addressing a colleague in a disrespectful manner is not something that is positive for anyone.”

It is also recommended to document major incidents. Record the date, time and nature of the event, which will help establish

a pattern of bullying. Also keep a copy of any emails, memos, faxes, etc.

If things do not stop after approaching the person, it is time to tell someone. If the workplace does not have a policy in place, contact a supervisor, manager, or even the human resources department. If there is a policy it will provide steps for raising concerns. A number of provinces, including Ontario, Quebec and Saskatchewan, have legislation concerning workplace harassment. In fact, in Ontario, employers are required to have workplace policies that address workplace harassment.

### What to do — employers

There are a few things that employers can do to avoid having a bully in the workplace, including:

- implement a workplace harassment policy. There should be zero tolerance for bullying in the workplace;
- train all managers and supervisors on the policy and how to deal with a bullying situation;
- listen to employees and be empathetic. If someone claims to be mistreated, take their comments seriously and investigate both sides thoroughly and have written procedures for investigating

## **Bullying can be psychological or physical and “usually involves repeated incidents or a pattern of behaviour that is intended to intimidate, offend or humiliate a person”**

these claims;

- lead from the top down. Setting an example for your employees and committing to a bully-free workplace will make things much easier. For example, include material about your organization's values and approach to workplace respect in weekly or monthly newsletters. This can serve as a constant reminder that workplace respect is valued by the employer; and
- hold bullies accountable. Address all situations. Although every situation is different, it is important to follow a consistent process and to ensure bullies are dealt with.

Bullying is detrimental to all parties involved. For such victims as Eileen, there are negative effects on mental and physical health, as well as an impact on their productivity.

As for employers, there are increased costs because of reduced efficiency/productivity, recruitment/training, engagement of mediators, etc.

Thankfully, Eileen did not become part of the 78% who have left their employers. She was guided in the right direction and handled the situation with confidence. Pat and Jenna responded well to her feedback and stopped the bullying behaviour. Eileen's firm developed an effective system to guide them in all future bullying incidents.

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# AND FINALLY...

## HOW THEY DO IT IN...



### INDIA

Budget management. Setting strategic directions. Ensuring regulatory compliance. Such duties are what management is all about, right?

What about asking the sales manager if her husband got that promotion he was hoping for? Or dropping that strategic plan you had been working on for weeks for one you just came up with, after finding that a new government policy has been implemented, making that plan impractical?

This is management, Indian style. At least, according to some.

While there is disagreement about whether one can put a finger on a typical Indian style of management — some say there is an “Indian way,” while others point out that there are no common styles across regions and companies — there seem to be some similar characteristics that encompass and affect how managers in the country operate.

For one thing, leadership style is affected by India’s business

makeup and culture. With 85% of businesses being family owned, many managers traditionally related with their employees on a more personal level, taking an interest in their employees’ family lives. As well, successive leadership was assured; when the time came to change ownership, the reins were automatically handed over to the owner’s children. But that is changing.

Because of competition from professionally managed companies, many family-owned businesses have raised the bar, hiring managers — nonfamily members — educated at one of the Indian Institutes of Management, which are business schools located throughout the nation. Even the children of owners are increasingly being educated at these institutes or other schools before taking on leadership roles.

Taking a personal interest in staff and a traditionally large degree of family succession aren’t the only characteristics of Indian management styles. Flexibility is a big one. In a country where constant change and complexity are part of the business environment, managers have become adept at being adaptable. Policy frameworks can change at any time. And complex elements, such as bureaucracy, a lack of resources and low-quality infrastructure (which can impede the flow of capital), can hamper daily business operations. Being flexible is not only desirable, it’s necessary.

Yvette Trancoso

## Where are they now? IAN SLATER



### Going for the gold

Back in 2007, Ian Slater, featured in “Invite to partner” in the January/February issue, was a 35-year-old hotshot partner at Ernst & Young, leading the firm’s Western Canada tax accounting and risk advisory service. Later that year, he left E&Y to find mineral properties with the rare potential to be developed into economic mines and to find experienced technical executives to lead

the projects. Several years earlier he had worked for Arthur Andersen in Moscow and Uzbekistan, where he set up an office that serviced Newmont Mining Corp., the second-largest gold-mining company in the world. He turned that office into the largest accounting practice in Central Asia.

Now he runs major Vancouver-based operations with mineral properties in Alberta, Colombia and Kazakhstan. He is the chairman and CEO of two companies: Slater Mining Corp., which he cofounded in 2008, and Red Eagle Mining Corp., which he cofounded

in 2010. He is also the chairman of Black Eagle Mining Corp., another company he cofounded in 2010.

Black Eagle is developing the Blackstone metallurgical coal deposit in Alberta, Red Eagle is developing the Santa Rosa gold project in Colombia and Slater Mining has the Kazakhstan government’s approval to acquire the West Khazret Gold Project. Four times a year, he travels to Colombia and Kazakhstan to meet with executives at Red Eagle and Slater Mining to discuss strategies, monitor progress and build relationships with local stakeholders.

Slater’s main responsibilities are to manage the companies — comprised of 50 full-time employees and many contractors — and oversee operations, including up to seven drill rigs and numerous metallurgy, engineering and environmental reports. He also raises funds for the operations by building relationships with investors and working through the due diligence process with them. “Last year, we raised \$65 million in a very difficult market,” he says.

What is he enjoying most these days about being involved in the mining industry? “Right now, it’s seeing a vision become reality with the construction of our first mine at Santa Rosa in Colombia next year,” he says. “That’s exciting.”

Lorie Murdoch



## CHRISTIE HENDERSON

The managing partner of Henderson Partners LLP may be familiar to you as coauthor of the national bestselling book *Tax Tips for Canadians for Dummies*. She has been nominated as one of Canada's Top 40 under 40 and received the Institute of Chartered Accountants of Ontario's Award of Distinction in 2009. Along with being an Oakville Hospital Foundation board member, she has served on the board of the United Way of Oakville and the board of governors of St. Mildred's-Lightbourn School. For the past 12 years, Henderson Partners has been running the Oakville Toy Tea, where attendees bring items for children in need. "Toys, warm coats and snowsuits go to the Halton Children's Aid Society, the Sexual Assault and Violence Intervention Services of Halton and other organizations," says Henderson. Here's what you'll find in her office.

### FAMILY PHOTOS

"I have three boys so I've got photos of them and my husband all over my office. I work full time and have a busy job but I have those photos to remind me of what's important."

### MARATHON MEDALS

"I started running marathons after I had my youngest son. All my marathon and half-marathon medals are hung over my diplomas in my office. I'm quite proud of those. I've traveled to Amsterdam, San Francisco and Washington [for the marathons]."

### BUSINESS BOOKS

"I have quite a substantial library of business books. I'm a bit of a fiend and I always have a big stack of business books on my bedside table. When I've read them, I bring them in and everyone from the office comes and helps themselves. One of [my] favourite books is *Good to Great*, by Jim Collins."

### ART

"I've got a couple of really beautiful paintings. The one that's hanging above my desk that I end up looking at most of the time is a flight of waterfowl flying over Lake Ontario and I absolutely love it. It's called *Lemon Birds*."

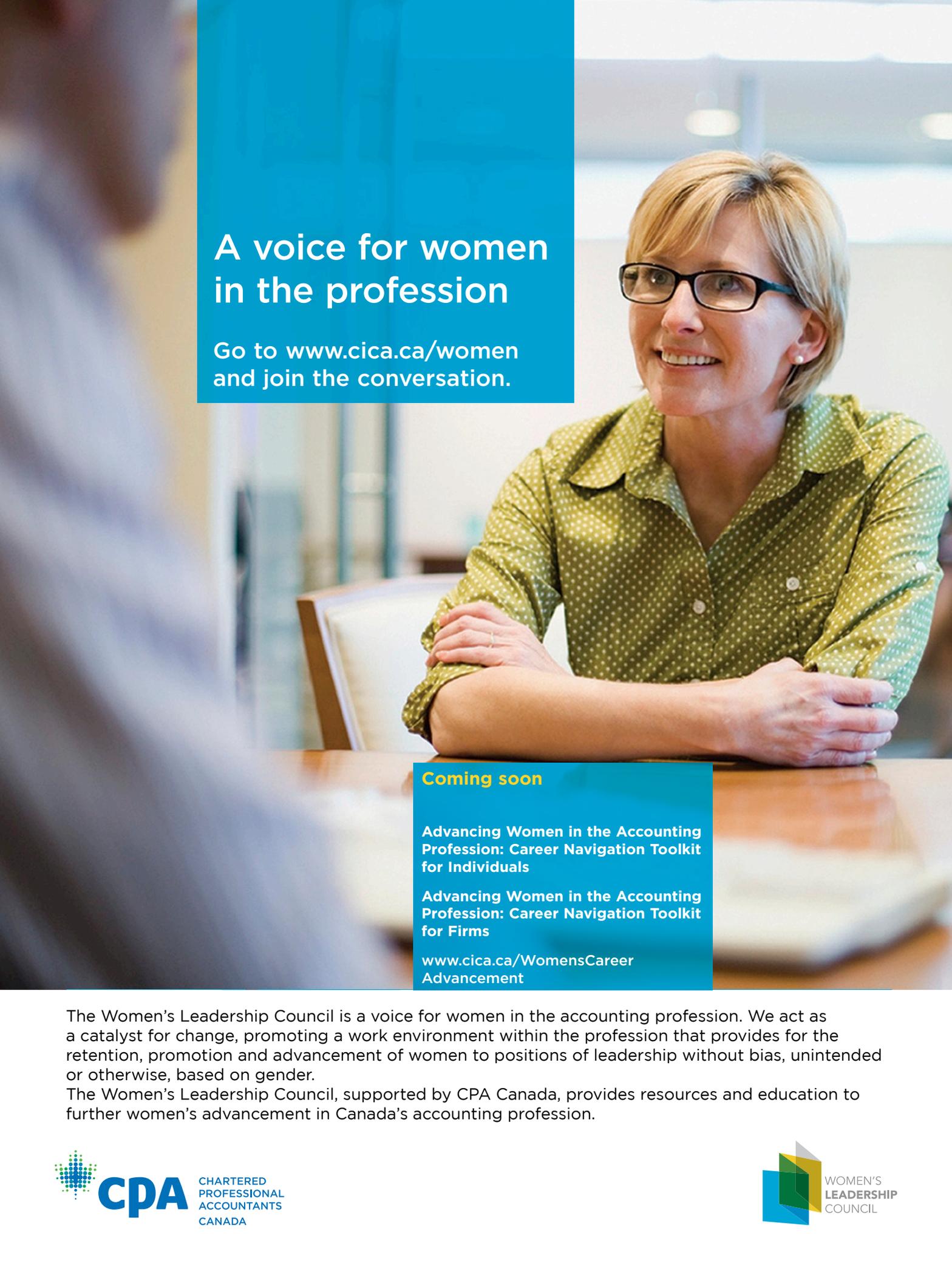


### MARBLES IN A GLASS JAR

"I belong to a CEO group and one of my friends and I came up with the concept of glass marbles in a jar. There are 52 marbles in the jar — one

for each week of the year — and the idea is that at the end of the week, you reflect. The marble representing that week is tossed in the garbage. You should ask yourself, 'Did

I spend [the week in] the best way possible?' Time is a very valuable resource and it's not renewable. You really get that sense as the jar empties throughout the year."



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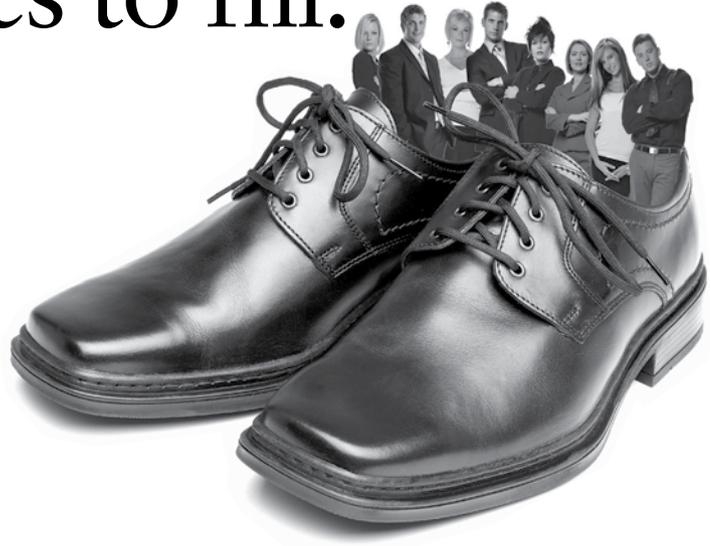
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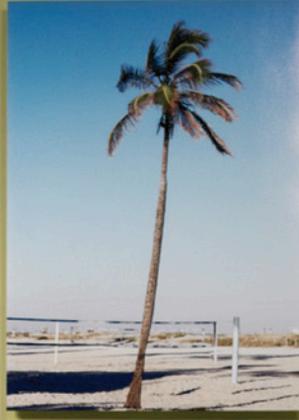
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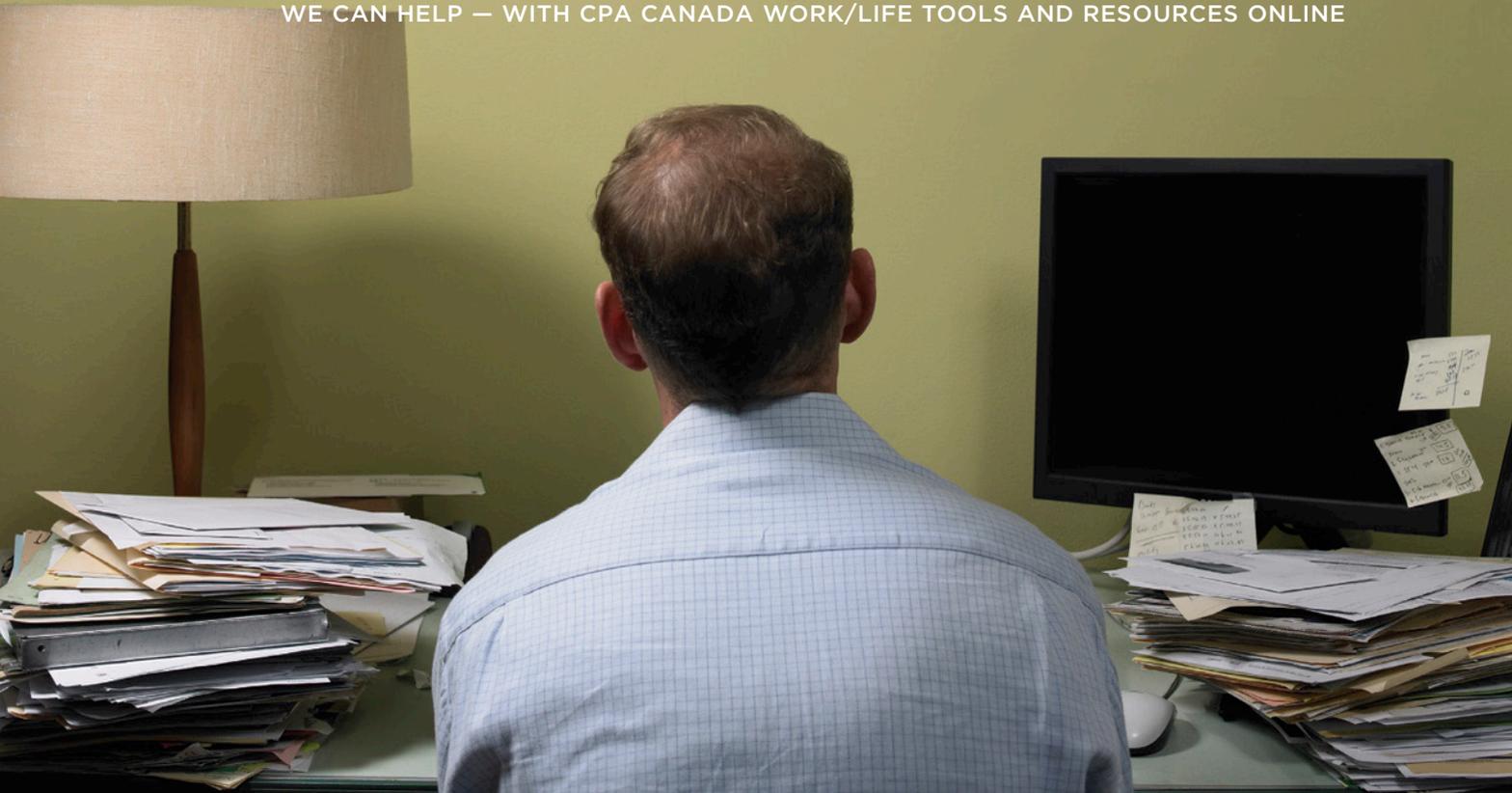
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## Infrastructure and maintenance

**P**lace Ville Marie, the real estate landmark in downtown Montreal, was built more than 50 years ago. The Toronto-Dominion Centre, which holds similar sway in Toronto, dates back to 1967.

For half a century, these two real estate complexes have conserved their proud, contemporary looks and remain among their respective cities' most prestigious addresses.

Why can't it be the same for government infrastructure? What condition are schools, hospitals and city halls in after 50 years? Why do roads and bridges fall into ruin so quickly? Welcome to the wonderful world of politics.

Governments face constant pressure from voters who want more spending and less taxes. In this environment, politicians, the public sector's ultimate decision-makers, seek to please by optimizing expenditures. However, a large part of the budget is politically untouchable, because, among other things, it consists of transfer payments to individuals, such as family allowances, or to institutions, such as schools and hospitals. Instead, politicians try to free some funds by cutting back on less useful programs and leveraging annual revenue increases. They also find wiggle room by cutting down on infrastructure maintenance, an expenditure that is not highly visible, has little short-term impact and does not resonate during election campaigns. As a result, infrastructure maintenance often bears the brunt when governments need to tighten belts.

The three main levels of government set aside less than 5% of their budgets (or less than 2.5% of GDP) for public infrastructure. The major part of these expenditures is allocated to new construction, which gives politicians highly prized ribbon-cutting opportunities. In general, maintaining infrastructure requires annual investments of at least 5% of their value, the same as the typical depreciation rate. If we assume that public infrastructure represents in value about 25% of GDP, governments at all levels should spend 1.2% of GDP (or \$2 billion a year) on maintenance for current infrastructure before building

new ones, such as filtration plants or community centres.

In fact, governments spend much less on maintenance than they should, as they are drawn to new infrastructure projects. As a result, infrastructure maintenance problems get worse year after year. Last year the Federation of Canadian Municipalities estimated that at the municipal level alone, there was a \$173-billion infrastructure shortfall for repairs, replacement of decrepit ones and building new ones. The problem is just as serious at the federal and provincial levels. Last fall, Canada's auditor general devoted a full chapter of his report to this issue, strictly for real properties at the Department of National Defence.

We won't change politicians and their fascination with new projects. Spending for infrastructure maintenance

### The three main levels of government set aside less than 5% of their budgets for public infrastructure

will never be politically appealing. So how can we remedy the situation? There is a solution.

As part of the annual audit, auditors general could be mandated to assess how government departments and agencies at all levels maintain their real assets. Given the backlog, the exercise may prove daunting initially. But the review could be performed on a five-year basis, reaching all departments and agencies. Eventually, as maintenance improves, audits could proceed through sampling.

The same exercise should be undertaken at the community level, where there are serious deficiencies, particularly in school boards and hospitals. Provincial governments could implement a control mechanism that would force local governments to allocate sufficient resources to properly maintain their equipment and infrastructure.

Deficiencies in public infrastructure maintenance entail more costs than commonly assumed. Rebuilding is always more expensive than maintaining. Before launching a vast new infrastructure program, Canada should first tackle the issue of infrastructure maintenance.

Marcel Côté is a strategic adviser at KPMG SECOR, Montreal



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