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Atlantic Tube & Steel

Frank Cancelli is the founder and president of Atlantic Tube & Steel (AT&S), a manufacturer of automotive and structural steel tubing headquartered in Mississauga, Ontario. “We’re a family-run business with approximately 35 employees,” says Cancelli. “We operate out of a 150,000-square foot manufacturing and warehouse facility, which, since the implementation of SYSPRO, has become highly automated.”

AT&S runs two mills: one makes mechanical tubing, predominantly for the automotive aftermarket; the other manufactures larger-sized structural tubing, used in a host of applications such as conveyor belt rolls, jackposts and trailer hitch tubing. AT&S also operates as a recutting service, to provide some of its customers with an additional value-added component. An ISO 9001 certified manufacturer, Atlantic Tube & Steel guarantees that its products meet rigorous standards, and every bundle of product is subjected to a series of quality tests to verify integrity and quality.

“One of the ERP capabilities that AT&S needed most was product traceability. “Quality, and the perception of quality, are of paramount importance in our industry,” says Larry Brandon, AT&S’s sales manager. “That’s why SYSPRO’s Lot Traceability component is a key benefit.” Steel, explains Brandon, can be manufactured in many forms using myriad components. “Too much or too little of certain components (carbon, for example) will affect the product’s malleability. And since many of our customers need to bend and shape the steel they buy, it must conform precisely to exacting specifications.”

If an order of steel does not conform to specification, and if AT&S receives a customer complaint, the company can now use SYSPRO to quickly identify the relevant production run. “With that information, we can take all the rest of that steel out of stock,” says Brandon. “That way we avoid sending the wrong product to other customers, which helps us eliminate, or at least minimize, any negative quality perceptions that might arise in the market.” Lot traceability also allows AT&S to drill down to the source components of any production run. “That saves us a lot of time. It also lets us go back to our suppliers in a timely fashion if their product doesn’t meet our specifications.”

Implementing SYSPRO has enabled AT&S to fully automate its production floors. “That allows us to look at the shop floor in terms of reducing man-hours,” says Bavcevic. “In addition, with SYSPRO we no longer need our manual production reporting process. In the past, while a mill operator was supposed to be watching the seam, or adjusting the heat source, he would sometimes have his back to the mill while he prepared his reports. These days, the whole production process, from input to output, is all recorded and reported by SYSPRO. Not only does that eliminate a ton of paperwork, it provides us with the ability to get information more efficiently, so we can analyze the data on a timely basis.”

For Atlantic Tube & Steel, the transition to SYSPRO has been rewarding. “We’ve joined the 21st century,” says Bavcevic. “In terms of IT, we were barely limping along. Now, with SYSPRO, we’re up and sprinting.”

For more information on Atlantic Tube and Steel please visit: www.atlantictube.com.
GAAP for private enterprises is here

Since the Accounting Standards Board (AcSB) decided to move publicly accountable entities from Canadian GAAP to IFRS, the question haunting private companies and the accounting firms servicing them was: what about us?

The past two years were particularly difficult for practitioners who could not answer clients’ questions about what they were supposed to do and prepare for, even though the AcSB determined early in the process that it would most likely not take the IFRS route for SMEs. CA magazine heard readers’ anxiety in meetings, as did members of the AcSB and the CICA Accounting Standards department when they consulted stakeholders on what should succeed current GAAP.

The proposed standards are now on the CICA website (www.cica.ca/index.cfm?ci_id=7970/la_id/1.htm) for interested parties to study and comment on. I highly recommend Jeff Buckstein’s article, “Private matters” (p. 20), for an overview of the proposed standards. It explains that the solution is a simplified version of GAAP as you know it, and it recognizes the financial statements of a private entity are not meant to accomplish the same things as those for public companies.

Practitioners are coming out of the exhausting tax season and firms’ partners may be wondering if there is a way to make things better or easier. Our second feature might be worth considering: offshoring the less value-added work. Outsourcing work to third-party contractors is not a new concept and now includes offshoring, meaning the work is sent outside the country. Having written about offshoring, meaning the work is sent outside the country. Having written about

**FROM THE EDITOR**

Christian Bellavance, Editor-in-chief

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upfront

4 PEOPLE
What started out as a simple task of clearing up paper piles turned into a home-based company for Tova Posner. When the Toronto-area CA couldn’t find a chic bulletin board to match her decor, she created one with form and function. Today hers is a fast-growing business with online orders from across North America.

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Hiring decisions are too hasty • Workforce woes • How to control your online reputation while looking for work • Numbers game • Going concern

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Calculating work-life conflict • Cold hard cash • Senior spending • Tax cheats not cool • Bank profit tally

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Directors enjoy new responsibilities • How does Canada measure up?

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It was a while in the works: the Accounting Standards Board is putting out the new standards for non-publicly accountable enterprises. And most of them are derived from the current Handbook.

BY JEFF BUCKSTEIN

26 The third-party solution
Outsourcing tasks traditionally handled by internal staff is not a new practice. In its current form, it’s being used by some CA firms with great success. And the benefits are easy to grasp: gains in efficiency and making better use of skilled staff.

BY PAUL BRENT

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Breaking news, tax updates, job postings, archives, more articles: you’ll find them all at www.CA magazine.com
Called to order

Neat idea: Tova Posner makes attractive magnetic boards and accessories for the style-conscious clutter-buster

When Tova Posner decided to sort out the piles of paper plaguing her Toronto-area home two years ago, she wasn’t thinking of starting her own business. But after a fruitless search for a chic and sophisticated bulletin board that suited her decor, the CA and avid crafter saw an opportunity to create a unique product — stylish wood-framed faux leather and suede magnetic boards that consider form as well as function. “I think it sort of took me by surprise,” says Posner, 31, of the launch of her home-based company, Magnique Inc. “I created one of the boards for myself and then ideas started to formulate in my mind.” By August 2007, she was ready to focus her energies on the business and see what she could do with it.

What she did was create some serious buzz, judging by the media coverage Posner and her Magnique boards and Italian-glass magnets have received from magazines including Style at Home, Chatelaine and Canadian Kitchen and Bath and television programs such as The Mom Show and CBC’s Steven and Chris. Sales of the $150 to $250 boards are building quickly, with online orders coming from across the country and the US, including a corporate order from a fitness club chain. Posner also promotes her self-described functional art at trade and craft shows, and is targeting interior designers and office-design firms as another potential market.

“Just think, in the time it takes you to watch your favourite TV show or have an extra-cheese-and-pepperoni pizza delivered to your home, employers are making million-dollar hiring decisions,” write the study’s authors.

Hiring decisions are even hastier in France, where 70% of interviewers surveyed spend 30 minutes or less reviewing candidates, and 30% devote less than 10 minutes to the task.

Résumé

2001 joins PricewaterhouseCoopers, Toronto
2004 obtains CA designation (Ont.)
2006 works as consultant, J and K Economics, Toronto
2007 starts Magnique Inc. (www.magnique.com)

Tamar Satov

UPFRONT
News, people, briefs, trends + tips

Hiring decisions are too hasty

Half of all job interviewers in Canada spend less than 30 minutes reviewing candidates’ interview results before making a decision — about the same time it takes the average Canadian to commute to work — a recent study finds.

That amount of time is “woefully inadequate,” according to consultancy DDI’s 2009 Survey of Global Interviewing Practices and Perceptions, which surveyed 1,910 interviewers and 3,523 job seekers worldwide.

“Just think, in the time it takes you to watch your favourite TV show or have an extra-cheese-and-pepperoni pizza delivered to your home, employers are making million-dollar hiring decisions,” write the study’s authors.

Hiring decisions are even hastier in France, where 70% of interviewers surveyed spend 30 minutes or less reviewing candidates, and 30% devote less than 10 minutes to the task.
WORKFORCE WOES

The current economic downturn will have a significant impact on Canada’s labour force, according to the first-quarter 2009 CICA/RBC Business Monitor survey.

More than half of the CAs in senior executive roles who responded to the survey expect their company’s workforce to decrease over the next 12 months, and a sizable 18% expect the decrease to exceed 10% of their current workforce.

When asked how companies are going to reduce their labour costs, layoffs remain the most common choice with 69% expecting layoffs over the next 12 months. This is closely followed by hiring freezes (65%) and reduced non-base compensation (63%).

Although a few companies have made the news recently for promoting voluntary reduced work hours as a way to minimize layoffs, the survey suggests this option is not yet being widely adopted. Given that many respondents expect the economy to recover by the second quarter of 2010, companies may want to consider these more positive alternatives to reduce labour costs.

John Tabone is CICA’s manager of member value and research services.
Rank of Canadians among US and European consumers in their intention to cut spending during 2009. According to a Boston Consulting Group study, 62% of Canadians surveyed said they would lower expenditures, compared with 58% of Americans and 56% of Europeans.

Year-over-year percentage growth in non-mortgage consumer credit and Canadian mortgages, according to a CIBC World Markets report issued in the summer of 2008. Household debt is rising faster than wealth, partly due to plunging stock values.

Percentage of Canadian household debt on each dollar of assets in 2007, according to a CIBC World Markets study. US households carried an average of 30% more debt.

Billions of dollars in outstanding Canadian consumer credit-card debt as of February 2008. Balances have risen 40% since 2004 and increased delinquencies could hit issuers with an additional $800 million in writeoffs on an annualized basis.

Year changes to Canada’s Bank Act allowed chartered banks to lend at rates higher than 6% and expanded their options for securing consumer loans. Between 1968 and 1978 the percentage of consumer loans held by banks rose to 62.8% from 36.7%.

Canadian households that had not paid their mortgage for at least three consecutive months as of September 2008. The figure represents 0.29% of Canada’s 3.9 million mortgages.

In 1978, outstanding consumer credit in Canada was $35.76 billion. Thirty years later the figure sat at $1.2 trillion. Here’s our credit report for Canadians.

In 1967, outstanding consumer credit-card debt of Canadians was $35.76 billion. Thirty years later the figure sat at $1.2 trillion. Here’s our credit report for Canadians.
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SENIOR SPENDING
More than three-quarters (76%) of Canadian retirees don't know how much money they spent during their first year of retirement, finds an Ipsos Reid poll conducted for RBC. Of those who did keep track, 46% spent more than they expected and 42% didn’t have any spending expectations. Just 12% spent less than they expected.

CALCULATING WORK-LIFE CONFLICT
Accountants may think they have one of the most challenging jobs out there when it comes to managing work-life stress — particularly coming off of April’s tax deadline. But that may not be the case, according to recent research that examined the behaviours required to perform 126 different occupations.

The study, published in the Journal of Applied Psychology, found more work-life conflict is associated with roles that require a high level of interdependence or interaction with others in the workplace, as well as those with increased responsibility for the work quality, output, health and safety of coworkers.

“For example, if a therapist is drained from helping people with their problems and can’t be there for his family at the end of the day, his home life suffers,” says the study’s co-author Erich Dierdorff, assistant professor of management at DePaul University in Chicago.

And while Dierdorff acknowledges increased work hours at tax time can certainly increase one’s work-life stress, the study found accountants and auditors actually experience an average level of conflict. “Compare yourself to a police detective of homicides or a firefighter,” he says. “It’s all relative.”

THE DRAINED AND THE STRESSLESS

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<thead>
<tr>
<th>Jobs among the most likely to have high work-life conflict (much higher than average)</th>
<th>Jobs among the least likely to have work-life conflict (much lower than average)</th>
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<tr>
<td>Police detectives</td>
<td>Maids and housekeeping cleaners</td>
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<td>Municipal firefighters</td>
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<td>Legislators</td>
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<td>Lawyers</td>
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<td>Registered nurses</td>
<td>Cooks</td>
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TAX CHEATS NOT COOL
The vast majority of Americans think it’s wrong to dupe Uncle Sam. In an annual survey of taxpayers’ attitudes conducted by the IRS Oversight Board, 89% of respondents say it is “not at all” acceptable to cheat on their taxes — the highest percentage to condemn cheating since the survey’s inception in 2002.

BANK PROFIT TALLY
Combined annual profits for Canada’s big six banks dropped $7.5 billion in fiscal 2008, according to PricewaterhouseCoopers’ annual banking survey. Profits were just more than $12 billion — down from a record $19.5 billion in 2007 — on par with the results from 2005. Sob.

COLD HARD CASH
A small minority of Canadian investors are taking drastic measures to protect their money from volatile markets — they’re hiding it around the house.

According to a TD Waterhouse poll, 2% of investors have considered storing their money in unconventional places and, of those, 3% actually went ahead and put it in the freezer, 3% stuffed it under the mattress and 2% stashed it in the cookie jar.

Of course, such actions neglect the long-term impact of inflation on purchasing power and are not advised by TD Waterhouse senior vice-president Patricia Lovett-Reid. “People shouldn’t let market volatility dictate their long-term financial planning and they should speak with an adviser who can help keep their retirement plan on track,” she says.
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How does Canada measure up?

How does Canada’s quality of life compare with that of the wealthiest countries in the world? Not as well as it should, says the latest Report Card on Canada. Even with all our gifts, including huge resource wealth and skilled human capital, we still get a B on our economic, education and social performance, C on environmental performance and health, and D on innovation.

The report card, an annual benchmarking study conducted by the Conference Board of Canada, shows that even in the current turmoil, the fundamentals still matter. Canada’s economy is performing well enough to rank among the best in the world. However, its 11th place ranking out of 17 peer countries on economic performance pushes it toward the back of the class. There are three reasons. First, the country is a chronic laggard on several important economic indicators — most notably, productivity. Second, it has failed to keep pace in the growing competition for global investment. Third, even in some areas where it has improved, other countries are doing better.

Achieving the goal that the Conference Board sets out for Canada — providing “a high and sustainable quality of life for all Canadians” — requires much more than economic success, says the study. Canada’s self-image as relatively kind and gentle is based largely on a narrow Canada-US comparison. But many Canadians would be surprised to learn that the US has lower burglary and suicide rates and greater gender equity than Canada. Nine countries rank above Canada overall, and Canada’s C grades on child poverty, income inequality and assault are troubling for a wealthy country, the study says.

This is a summary. For an expanded article in which the Conference Board of Canada outlines more findings from the report card, visit camagazine.com/canada.

Based in Boston, Stephen Mader is the vice-chairman and managing director for Korn/Ferry International’s board services practice.

Directors enjoy new responsibilities

More work and less play? Today’s corporate directors seem to like it that way. A high level of job satisfaction is one of the trends identified in the 34th Annual Korn/Ferry International Board of Directors Study, which also found that directors now serve on fewer boards but work longer hours — 16 hours a month per board in North America, versus 9.5 hours 20 years ago.

The study is based on responses from almost 800 directors in Asia Pacific, North America and Europe, as well as a quantitative analysis of proxy data from 891 Fortune 1000 organizations. It shows board size has decreased to an average of 10 directors. In 1973, the first year Korn/Ferry conducted its annual board study, one in every five boards had between 16 and 25 directors.

Women and minorities are no longer strangers to the boardroom, but their participation has reached a plateau. Today, 15% of Fortune 1000 companies still have an all-male board. Only in Scandinavia have women made real progress in this area. In Norway, legislation was passed in 2004 that by 2008, 40% of board members must be women. The target was almost reached.

While it is increasingly challenging to recruit high-quality directors, boards are having more success recruiting directors with specialized skills, such as financial expertise. And directors themselves are getting more comfortable with the idea of being evaluated for their individual job performance and that of the board as a whole. While they are working harder, they are being paid more, especially through the use of annual retainers and restricted stock.

Most directors say they have a formal evaluation process for the CEO in place. Many are emphasizing pay for performance. Directors are expected to be more familiar with the various aspects of executive compensation so they can analyze and often redesign executive compensation packages. Among other changes, there has been a shift toward a portfolio of various long-term incentive vehicles for executives. When the CEO also chairs the board, the trend is to designate a lead director from among the independent directors to preside at executive sessions and to evaluate the CEO.

Sarbanes-Oxley has been a reality in the US for more than five years, and two-thirds of directors think it should be repealed.

This is a summary. For an expanded article, visit camagazine.com/boardstudy.

Based in Boston, Stephen Mader is the vice-chairman and managing director for Korn/Ferry International’s board services practice.
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Internet will help drive recovery

As we worry and wonder about the state of the global economy, we should remind ourselves that one thing is certain. At some point in the future, newspapers will run banner headlines featuring the words “Economic Recovery.”

The challenge with this particular downturn is that every single event — downsizing, layoff, missed earnings target or corporate bankruptcy — is now repeatedly examined in depth on 24-hour news channels. As a result, it’s easy to lose sight of the following key trends, which will help lead us into economic recovery.

Infrastructure There is no doubt there will be a significant national economic stimulus due to infrastructure spending, but I believe we’re entering the era of smart infrastructure, which will involve more than shovels and buckets. For example, roadworks projects will use smart-highway technology, such as the linkage of spatial databases (think Google Maps) to GPS technology embedded in cars. It won’t be long before you can put your car on autopilot, so to speak, carefully keeping up with traffic flow as measured by highway-embedded sensors. Science fiction? I don't think so. Put it this way: every bit of new infrastructure will be integrated with the Internet, and that will provide for some fascinating opportunities.

Healthcare The ramp-up in healthcare spending that will occur as boomers age will be staggering, and this will perversely drive job growth at the same time it strains the budget. In the US, healthcare spending could equal 60% of gross domestic product in some states within 10 years. Such stark realities are driving furious rates of business model, technological, structural and other innovations in healthcare, much of which will involve sophisticated Internet technologies. For years, I’ve been talking about the potential for bio-connectivity devices: smart home-based medical monitoring technologies doctors can use, via the Internet, to monitor noncritical-care patients. Such innovations will drive a variety of growth-oriented markets.

Environment Despite the slowdown, there is no pullback in major efforts to deal with challenging issues, which means ecological spending will continue to drive growth markets. McDonald’s is investing in a new company-wide intelligent energy infrastructure management system to deal with annual energy costs of US$1 billion. It expects to reduce overall costs by 20% by having the ability to remotely manage and monitor fryers, air conditioning, water usage and other devices throughout thousands of its restaurants. This will involve using the Internet as a backbone to a sophisticated global energy management system.

Industry reinvention Similarly, connectivity will play a key role in the reinvention of products and industries. There is a lot of talk about the concept of Car 2.0, which involves a fundamental reinvention of current transportation mind-sets. There is a strong belief that we will see a reinvention of the auto industry, particularly as Silicon Valley begins to laser-aim its focus at the next generation of automotive business model. The next-generation automobile, if it emerges from the land of high-tech, will have “connectivity” as its middle name.

The change agenda of Generation Y As I described in last month’s column (“They’ll spice up your systems,” p. 14), the members of this technologically aggressive, entrepreneurial generation will completely reshape the fundamentals of every industry, driving economic growth.

All in all, my view is that beyond a three- to six-month horizon, we will start to realize areas of economic growth, and the Internet will continue to play a key role.

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

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Sheila Botting
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CICA initiatives focus on providing significant member value

CICA’s mission is to foster public confidence in the CA profession by acting in the public interest and helping our members excel. In the coming year, supporting you through the transition to international financial reporting standards (IFRS), the evolution of Canadian GAAP for private enterprises and the transition to international standards for auditing in Canada (CAS) will continue to be one of CICA’s key initiatives.

A dedicated website called Canadian Standards in Transition has been established by CICA as a gateway to the CA profession’s information and learning resources on the changing landscape of Canadian standards. The website has been introduced to help Canada’s CAs make the transition to IFRS and the new CASs and to connect you to what you need to stay informed on changes to financial reporting for private enterprises, not-for-profit organizations and public sector entities. Available through the home page of CICA or any of the provincial institutes/ordre, this site is updated regularly to provide the latest information. It offers a range of insightful publications, training and self-study materials, as well as course and conference registration information.

In the year ahead, CICA will continue to play a critical role in enhancing and protecting the reputation of the CA profession. Maintaining our “best in class” reputation with key stakeholders such as Canadian business leaders, governments, regulators and internationally influential groups contributes substantially to the value and pride that come with having the right to use the CA designation. Together with the provincial institutes/ordre, CICA will continue to communicate frequently with all stakeholders about the CA brand and our profession’s role in promoting public interest. In addition to continuing our very successful Decisions Matter advertising campaign, we will continue to reinforce the value of CAs and the CA brand through proactive media, government and stakeholder communications.

Publications and tools that support you in your work with clients and employers are another very important benefit offered to you by CICA. In addition to the publication of CAMagazine, we develop valuable practitioner support such as Trust Services, PrimePlus and CICA’s Privacy resources to help expand the professional services you can offer your clients.

Notice to Members

2009-2010 CICA Member Fee

The CICA Board of Directors has set the 2009-2010 CICA member fee at $460 — an increase of $15 over last year’s level. The last fee adjustment was made in 2007.

This funding will contribute to a number of important member benefits including:

• finalizing GAAP for private enterprises and initiating discussions on a reporting framework for not-for-profit organizations;
• increasing the amount of guidance material issued on IFRS, ISAs, Private Enterprise GAAP, the financial crisis, risk and sustainability;
• enhancing our focus on members’ needs in tax;
• enhancing our international relationships;
• continuing to work with the provincial CA institutes/ordre to implement the CA Profession Strategic Initiatives.
clients. Resources such as CA Source, Director Source and the Succession Planning Toolkit for members in public practice are designed to help CAs manage their careers. Throughout the economic crisis we will be offering support by focusing on issues impacting employers, clients and careers. Upcoming initiatives include a new Member Savings Program; more webinars in our popular CA Source and CA Practice Advantage web-cast series; new publications on business management for SMEs and SMPs; and enhanced economic crisis coverage in our Report on Industry and CA Practice Advantage newsletters.

CICA also adds value in another important member benefit — education. In the coming year, CICA will focus on a number of important new education initiatives including implementation of practical experience requirements for the CA profession, expanding both the number of CA training offices and the opportunity to hire CA students; the delivery of comprehensive IFRS training to help you manage the transition to IFRS; and a wide choice of courses and conferences to contribute to your continuing professional development and your clients' or organization's success.

CICA also provides thought leadership, research and guidance that benefits the public interest and fosters public confidence in the CA profession. These activities focus on enhanced audit quality, effective governance and risk management, and transparent business reporting. A soon-to-be-published report will discuss and evaluate the various approaches to providing assurance at the data level. The 20 Questions for Directors series will be expanded with publications about the board's response to allegations of wrongdoing and about questions the board should ask about the HR/Compensation Committee. Meanwhile, the growing library of guidance on MD&A reporting has recently been supplemented with material on reporting climate change issues. In addition, alerts discuss important current issues for a variety of stakeholder groups. Recently published alerts include MD&A Disclosures in Volatile and Uncertain Times: Volume 2 — Analyzing Change and Liquidity and The Global Financial Meltdown — Questions for Directors to Ask.

In the coming year, CICA will be expanding its international participation on behalf of the CA profession. Increased service on boards and committees of world organizations such as the Global Accounting Alliance and the International Federation of Accountants and participation in the financial support of their operation will help ensure that Canada's CA profession maintains a strong influence among global accounting bodies.

Closer to home, CICA will be continuing to make an important contribution, both financially and intellectually, to the work of the Council of Senior Executives in delivering its strategic plan. The most significant deliverables in the coming year will be focused on the CA brand vision and branding strategy for 2010 and beyond; continuing work on harmonizing practice inspection processes; and collaborating with NASBA on a mutual recognition education program.

CICA is working hard to achieve its mission and to provide the resources you need to excel in your profession. We would like to hear your views on how we could enhance the member value we deliver. Your feedback will help guide us in future planning. Please contact us at executive.office@cica.ca.

### Net expenditures funded by CICA fee of $460 per member

(Total 2009-10 planned expenditures of $56.6 million minus other sources of funding of $26.9 million = $29.7 million)

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<th>Category</th>
<th>Amounts in $ millions</th>
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<td>Education</td>
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<td>Products and services including CA magazine</td>
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CAmagazine | May 2009 15
AcSB issues second omnibus exposure draft

The Accounting Standards Board (AcSB) has issued its second omnibus Exposure Draft entitled Adopting IFRSs in Canada, II, confirming the January 1, 2011 adoption date and clarifying the definition of publicly accountable enterprises. Other highlights of the exposure draft include:

• availability of the IFRSs in effect at January 1, 2008;
• confirmation that IFRSs will be applied to an entity’s first interim financial statements in the year of adoption;
• new introductory material that will replace the Introduction to Accounting Standards currently in the Handbook.

Clarification of PAE definition
Based on comments received from the public on the proposed definition of PAE included in its April 2008 omnibus Exposure Draft, the AcSB has made amendments to clarify the meaning of key terms such as “public market” and “fiduciary capacity.” The amended definition states that a “PAE is an entity, other than a not-for-profit organization, or a government or other entity in the public sector, that has issued, or is in the process of issuing, debt or equity securities that are, or will be, outstanding and traded in a public market [a domestic or foreign stock exchange or an over-the-counter market] or holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.” The full text of the definition can be found at www.cica.ca/ifrs

Timing of the changeover to IFRS
Although the AcSB gave consideration to the impact on its IFRS strategies of recent events, including the current financial market uncertainty, it has confirmed the January 1, 2011 adoption date. The board stated that adequate advance notice has been provided, and many entities are proceeding well with their preparations based on the understanding the date would not change. Furthermore, the Exposure Draft explained, delaying the effective date would require the AcSB to reconsider the timing of adoption of some global accounting developments that it previously decided should be adopted at the Canadian changeover date. Revising the adoption date could result in the transition to IFRSs occurring at a time that makes ongoing changes to certain of the standards less manageable from a Canadian perspective.

While the latest omnibus Exposure Draft invites public comment on the eight specific standards issued since the 2007 IASB Bound Volume and included in the 2008 Bound Volume, it also provides essential text of the body of IFRSs in effect at January 1, 2008, making it a valuable resource for financial professionals and students. To view the omnibus Exposure Draft, go to www.acsbcanada.org/ifrs_exposedraft.

A third and final omnibus Exposure Draft of IFRSs is expected to be issued in the second half of 2009 to invite public comment on additional changes to IFRSs made by the IASB since the 2008 Bound Volume. Following this process, IFRSs will be included in the CICA Handbook — Accounting in late 2009.

The AcSB is asking for comment on four questions outlined in Adopting IFRSs in Canada, II by May 15, 2009. Updates will be made public on the AcSB website, www.acsbcanada.org.

CAs offering further reporting guidance in volatile times

Canada’s CAs are providing further guidance to help companies communicate to investors as the global economic crisis continues.

Last fall, CICA issued a special alert aimed at helping companies supplement financial statements by providing useful information through management’s discussion and analysis (MD&A). A recently issued Canadian Performance Reporting alert titled MD&A Disclosures in Volatile and Uncertain Times — Volume 2 (PDF) sets out additional considerations when preparing MD&A in a challenging economy.

“Investors want a frank discussion focusing on what has changed with specific attention to an entity’s ability to fund its plans for the immediate future,” says Chris Hicks, principal with the CICA’s knowledge development. “This may involve entities changing the structure of their MD&A to better meet the information needs of investors in these challenging times.”

The major drivers that have changed as a result of the tough economic climate should be considered when preparing MD&A. For many entities, these may be summarized as the five Cs:

• credit availability and cost
• customer demand
• currencies
• commodity prices
• counterparties

“Investors rightly bring heightened skepticism to management’s assessment in tough times,” says Hicks. “A thorough discussion of liquidity is essential. This should be able to be read as a stand alone part of the MD&A and should include how the risks of changes in the major drivers relate to liquidity.”

Both the original alert and Volume 2 can be found on a special CICA site dedicated to the global financial crisis (www.cica.ca/financialcrisis). The special site provides one-stop access to information and guidance to help CAs and other leaders in Canada’s business and governance communities manage in these challenging times.
It’s how your transition to IFRS should be.

The date to change over to International Financial Reporting Standards is fast approaching and the time to prepare is now. We’re here to help. We understand the complexity of the transition and offer the information, tools and training you need to successfully manage the change to IFRS. So when 2011 rolls around, your transition will be seamless.

www.cica.ca/IFRS

Your trusted source for everything IFRS.
The CICA has developed information and guidance to help members and other leaders in Canada’s business and governance communities manage through these challenging times. Many of these resources are provided on a special CICA site dedicated to the global financial crisis (www.cica.ca/financialcrisis).

The Global Financial Crisis site is expanding rapidly. In addition to providing one-stop access to commentary, guidance and announcements from the Accounting Standards Board (AcSB), the Auditing and Assurance Standards Board (AASB) and Accounting Standards Oversight Council (AcSOC), the site provides links to relevant information and guidance from the CICA.

Visitors to the site can link directly to guidance such as MD&A Disclosures in Volatile and Uncertain Times, Volumes 1 and 2 from the Canadian Performance Reporting Board. These documents set out key considerations for preparing MD&A in a challenging economy. Also accessible from the site are Director Alerts such as The Global Financial Meltdown, published by CICA’s Risk Management and Governance Board. This alert raises questions that directors should ask so that they can more clearly understand what is currently happening within their corporations and ensure that management is adequately preparing and positioning for what lies ahead. Other links on the site point to feature articles from CAmagazine that specifically focus on the current state of the economy. Soon, a new scenario-based planning tool will be added. It will examine possible outcomes of the current economic downturn and explore what companies should do to position themselves to prosper when the economy finally restabilizes.

The CICA also offers a variety of webinars to help members deal with the financial crisis. The recently launched CICA/RBC Business Monitor webinar series provides insight into some of the key areas identified by chartered accountants in executive positions, as part of a quarterly survey conducted by CICA/RBC on the top issues facing businesses and the state of the economy. For members seeking their next job, the CA Source webinar series offers helpful career advice and covers topics included in the CareerVision e-newsletter as well as on the CA Source career site. CA Source will also selectively offer reduced pricing for firms posting jobs, an initiative intended to help all members through this difficult period. The financial crisis will also be the focus of both the CAPA and ROI webinar series, geared respectively to members in practice and members in industry, and a new CAmagazine webinar series that will be launched in the near future.

Small and medium enterprises (SMEs) and small and medium practices (SMPs) are the focus of several timely new business management toolkits being developed by CICA. The Financing Toolkit is a guide to financing alternatives aimed at the SME market. The Cash Management Toolkit provides entrepreneurs with a roadmap to help them find the optimum balance between products and services and earnings and expenses. A third product, The Estate Planning Toolkit, offers valuable advice to CAs who are nearing retirement so they can better manage their personal and business estates. CICA has also begun distributing Clients4Life, an Institute of Chartered Accountants of Saskatchewan (ICAS) publication, which is designed to help firms retain their best clients. Additional benefits will provide further support to members during these difficult economic times. The CICA and provincial institutes/orde have negotiated special member offers on a variety of products and services with a select group of suppliers. The CA Member Savings Program, launched in January, is provided as a value-added benefit for members. To find out more details, visit your provincial institute’s website.

Every two years, the CICA and the provincial institutes/orde conduct a profession-wide compensation survey. The survey results are a valuable tool for members to benchmark their salaries against other members in their region and are used to promote the profession to students across Canada.

Beginning in late May, members will receive an e-mail invitation to participate in the survey from CICA’s research provider, iTracks. Participants will receive an advanced copy of the results in early September. The complete results of the study will be available to all members by mid-October.

The CA 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 questions regarding the survey, please contact Paul Long, manager, marketing and marketing research at paul.long@cica.ca.

Results of the 2007 CA Compensation Survey can be found at www.casource.com/employerGlobal/initArticleSearchAction.do?id=3&catId=11.
### Standards digest

Want to be kept informed? Log on to www.cica.ca/subscribe

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**RECENTLY ISSUED PRONOUNCEMENTS**

<table>
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<th>Handbook / Statement</th>
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| CICA Handbook – Accounting | † | Business Combinations, Section 1582 January 2009  
Consolidated Financial Statements, Section 1601 January 2009  
Non-controlling Interests, Section 1602 January 2009 |
Mining Exploration Costs, EIC-174 March 27, 2009 |
| CICA Public Sector Accounting Handbook | † | Transitional provisions amendment to Government Reporting Entity, PS 1300 March 2009 |
| Public Sector Statements of Recommended Practice | † | Indicators of Financial Condition SORP-4 May 2009 |

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**RECENTLY ISSUED DOCUMENTS FOR COMMENT (to April 30, 2009)**

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| Accounting | † | EDI Adopting IFRS in Canada, II May 15, 2009  
EDI Consolidated Financial Statements April 20, 2009  
EDI Embedded Derivatives on Reclassification of Financial Instruments May 15, 2009  
ITC Financial Reporting by Not-for-Profit Organizations* June 30, 2009  
ED Generally Accepted Accounting Principles for Private Enterprises July 15, 2009  
EDI Income Tax June 30, 2009 |
| Auditing and Assurance | † | rED Agreeing the Terms of Audit Engagements April 15, 2009  
ED Auditor’s Consent to the Use of the Auditor’s Report in Connection with Designated Documents June 30, 2009 |
| Public Sector | † | ITC Financial Reporting by Government Organizations April 17, 2009  
ITC Financial Reporting by Not-for-Profit Organizations* June 30, 2009  
rED Government Transfers September 15, 2009  
SOP Liability for Remediation and Mitigation of Contaminated Sites May 29, 2009  
rED Tax Revenues June 30, 2009 |

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

* Jointly issued by the Accounting Standards Board and the Public Sector Accounting Board

The information published above reflects best estimates at press time. Please visit our website for the most recent information.
It was a while in the works: the AcSB is putting out the new standards for private entities. Most of them are derived from the current *Handbook*

**Private Matters**

By Jeff Buckstein

The profession has been waiting for this for a long time and finally, things are changing. The conventional wisdom in accounting standards used to be one size fits all; people believed that a single, wide-ranging umbrella could cover the needs of businesses of all stripes. Not any more. The Accounting Standards Board (AcSB) adopted differential accounting standards for non-publicly accountable enterprises (non-PAEs). The AcSB has issued an exposure draft proposing new Canadian generally accepted accounting principles (GAAP) specifically for private enterprises. The AcSB is canvassing the opinions of not-for-profit organizations to see if these guidelines would also be suitable for them.

“We worked with an advisory committee that included both preparers and...”

Illustration by Dan Page
The AcSB has gone to the end users to ask, Who gets your financial statements? Why do they get them? What do they do with them?

The aim: to provide a simpler approach without compromising quality

users of private company financial statements to identify what’s really needed and important for the users, and what’s difficult for the preparers,” says Peter Martin, director of accounting standards at the Canadian Institute of Chartered Accountants. “This process helped identify which of the current requirements were really important. That’s why the board has worked so hard to come up with a sensible approach to financial reporting that accommodates a scale running from the very small to enormous global organizations.”

This change in direction reflects a recognition that the financial statements of public and private companies are meant to accomplish different things. A public company’s primary focus is on providing investors with sufficient information to make decisions about whether to buy, sell or hold securities.

“For a private company, you can’t say that’s irrelevant, but it’s much less frequent, because its securities aren’t publicly traded. They’re usually closely held — often passed down generation to generation,” says Toronto-based Paul Cherry, newly appointed chair of the International Accounting Standards Board’s Standards Advisory Council and former chair of the AcSB.

“So the AcSB has gone to the end users to ask, Who gets your financial statements? Why do they get them? What do they do with them? And we worked from there to determine where we can provide a simpler approach without compromising quality,” Cherry says.

Upon review, the vast majority of current accounting standards in the Handbook were considered acceptable for private business. Because they have existed for a while, and people are used to them, they will be incorporated into the new standards for private enterprises.

“The nice thing is that it’s all derived from the current Handbook. The bulk of the material [more than 80%] is what they’ve already seen,” says Ron Salole, CICA vice-president of standards. “So I don’t think as big a retooling effort is needed as with IFRS,” he says.

But a small amount of existing Handbook material got a major overhaul as far as future applicability to non-PAs was concerned. “We’ve been able to chop out whole standards; in a couple of places a few bits and pieces within individual standards were chopped out as well,” says Martin. “There was no point carrying forward standards on topics that are irrelevant to private enterprises.”

That led to some important differences. For example, says Martin, “we have a standard telling people how to calculate earnings per share (Section 3500). That standard is not applicable to nonpublic companies; it’s only public companies that really provide that information, and it’s only relevant to those sorts of companies. So there’s no need to carry forward that standard and it was just simply dropped.”

The standard on interim financial statements (Section 1751) also received close scrutiny. Because interim reporting is typically only applicable to public companies, and private companies generally only report annually using GAAP, this standard was left out of the new requirements for private enterprises. Similarly, the standard for segment disclosures (Section 1701) is mainly a public-company reporting requirement so it won’t be required for use by private companies under the new GAAP.

Income taxes (Section 3465) also warranted close examination. Income taxes have been contentious for many years, featuring an ongoing debate between future income tax accounting versus taxes payable accounting, says Bob Young, Toronto-based partner in the national assurance and professional practice of KPMG and member of the AcSB’s advisory committee to assist with implementing private company standards.

One of the AcSB’s decisions is to allow private enterprises to use the taxes payable method as an alternative to the future income taxes method under which they are required to account for future taxes payable. Also, because financial professionals in private companies may be more comfortable than those in public companies in using professional judgment, there wasn’t the need for a lot of detailed rules for how to apply standards and basic principles, says Martin. “So we’ve been able to cut back quite a bit there.”

For instance, one area that was reduced substantially involved the Emerging Issues Committee abstracts that have accumulated over the past 20 years. “With the exception of a few bits and pieces of extracts that happen to be more principled than detailed guidance, which we will carry forward, the vast bulk of abstracts are considered too detailed and unnecessary, so we were able to prune those away,” Martin says.

Ditto for financial statement note disclosure. The first step in determining what was relevant to private company financial statement users was to take a hard look — for the first time — at all the costly universal disclosure requirements.

“We’ve accumulated quite a large set of disclosure requirements over the years,” says Martin, “but a number of the specific requirements are not pertinent or needed in the private-enterprise sector. So we’ve gone through all the requirements and essentially tried to take a clean sheet of paper approach [to] figure out what disclosures are useful and necessary.”

In general, the overall reduction applicable to many private firms should be in the 40% to 50% range, he adds. For example, a line item on the balance sheet that reads “property, plant and equipment, net of accumulated depreciation” currently requires a breakdown of that number under full GAAP. But under the new standards, a private company wouldn’t be required to give that level of detail — because most readers wouldn’t typically be looking for that kind of analysis (or if they did need it, they might already have it from another source).
A lot of what publicly accountable enterprises need to present in terms of financial disclosure focuses on what market analysts want. And market analysts demand as much information as possible, says Armand Capisciolto, national accounting standards partner with BDO Dunwoody in Sault Ste. Marie, Ont.

In contrast, the users of a typical private company’s statements are not analysts. “They’re local bankers and leasing companies,” Capisciolto says. “They don’t want to read financial statements that are 100 pages long. Some of the information currently being provided in financial statements of publicly accountable enterprises isn’t that relevant to the users of private companies, so I think they will very much appreciate this change,” he says.

Reducing those types of disclosures is an important simplification that can also reduce the extra costs it would otherwise take to prepare and possibly audit them, he adds.

It was not a problem deciding whether and/or how to apply the vast majority of Canadian standards to non-PAEs. However, there were approximately 10 issues involving differences between PAEs and private enterprises that caused some difficulty, and most of those were resolved by a decision to keep existing differential reporting options intact by “hard-wiring those into the standards,” says Salole.

Consequently a lot of the things that private companies are doing right now by virtue of differential reporting they will continue, using the proposed new GAAP for private enterprises.

But that still left the AcSB grappling with two really tough issues involving how to account for financial instruments, as well as consolidations, notes Salole.

Financial instruments are covered under Handbook Section 3855. Consolidations are reflected in subsidiaries (Section 1590); investments (Section 3051; 3050 in the XFI version); and interests in joint ventures (Section 3055). The AcSB agreed that financial instruments of private enterprises could be accounted for at historical cost, with two exceptions: equity investments that have a readily available fair market value (FMV) through a publicly quoted market price; as well as the holdings of any free-standing derivatives that are not used for specified hedging purposes, both of which would have to be expressed at FMV.

“We have made quite a side turn, if you will, relative to the financial instruments standards developed to date that you’ll find in today’s Handbook,” says Martin. “People have been pressing us to get away from some of the complexities of those standards and to get away from fair value measurements.”

Removing many financial instruments from the fair value model and stating them at historical cost will make things easier, says Young, who notes that historic cost information is more readily available and thus easier for a public accountant to either review or audit than fair value information.

Under the new GAAP, private companies will also be able to handle consolidations differently than PAEs, which must consolidate subsidiaries they invest in.
How did we get from there to here?

The movement to obtain unique standards that would apply to non-publicly accountable enterprises (non-PAEs) began during the mid-1990s, when the Accounting Standards Board (AcSB) established a study group to examine the merits of continuing along the traditional path of a one-size-fits-all standards approach, or permitting exceptions to that rule for smaller, private enterprises.

The conventional wisdom then was that the same standards should apply to all types of profit-oriented enterprises, regardless of their size or public/private status, says Ron Salole, vice-president of standards at the Canadian Institute of Chartered Accountants in Toronto. But thinking began to change about 10 to 15 years ago in the face of what became known as the big GAAP/small GAAP dichotomy.

A research report commissioned by the AcSB entitled Financial Reporting by Small Business Enterprises, published in 1999, reinforced that new thinking by concluding that standards were becoming too complex for smaller, privately held companies and that a one-size-fits-all approach might not be the best way to go after all. It recommended that Canadian GAAP allow for differential reporting options.

In 2000, the AcSB created a Differential Reporting Advisory Committee to provide input into the standard-setting process from the perspective of a private enterprise and to consider further the notion of differential reporting and how to make that work.

As a result of these processes, “the AcSB became convinced — and this was a significant mind change — that we would have differential reporting if certain conditions were met,” says Salole. Those conditions, covered in Section 1300 of the Handbook, which were adopted as part of Canadian GAAP effective January 1, 2002, included the need for qualifying enterprises to be privately held, without broad-based owners or shareholders. Also, enterprise owners had to unanimously consent to the use of differential reporting.

Differential reporting options, when originally introduced, affected the following six Handbook sections (there have been adjustments since):

- Section 1590: Subsidiaries — use of the equity method or the cost method;
- Section 3050: Long-term investments — use of the cost method;
- Section 3055: Interests in joint ventures — use of the equity method or the cost method;
- Section 3240: Share capital — limitation of the disclosure to issued classes of shares;
- Section 3465: Income taxes — use of the taxes payable method with new disclosures; and
- Section 3860: Financial instruments — disclosure and presentation.

In 2006, the AcSB undertook further research to talk to external users and find out what they needed from financial statements, says Salole. The result was the issuance of an invitation to comment supported by a detailed discussion paper that proposed three options for private firms going forward.

The first option involved modifying GAAP for non-PAEs by deleting certain requirements or embedding different treatments in IFRS, similar to the differential reporting model. The second option was to pick up an initiative known as IFRS for small and medium-sized enterprises, proposed as a simplified, self-contained set of accounting standards appropriate for smaller, non-listed companies. The third choice was an independently developed set of standards, a made-in-Canada option whereby the AcSB would develop a unique set of standards for non-PAEs, either by drawing on existing standards as a source, or starting fresh.

The rationale behind private enterprises not having to adopt the same standards as PAEs is that the latter tend to look toward global markets to raise capital; whereas private enterprises, by definition, don’t have broadly based stakeholder groups. They’re all here in Canada, so having access to global markets is not as significant, says Salole.

As the made-in-Canada option was fleshed out, it carried the day. “We were able to take our Handbook and quickly draft a slimmed-down version that would apply just to private enterprises. We were able to demonstrate what the third option might look like, and there was overwhelming support for that,” says Salole.

After a great deal of discussion, the board came to the conclusion in February 2008 that of the three options the one that seemed to be the best fit at this particular time would be the made-in-Canada standards, but with modifications from existing GAAP, Salole adds.

Canadian standard setters view that as a step in the right direction, because private enterprises will be able to stick not only with Canadian GAAP, but also an adapted form of GAAP that is better suited to their needs, Salole notes. Moreover, there will be some two million private-enterprise corporations in Canada that avoid “the enormous change management that is going to occur in adopting full IFRS.”

JB
From a logical standpoint, it is expected that the proposed new GAAP standards should make life easier for both preparers and users of financial statements. Everybody is happy the AcSB is doing this.

“We have an investment in a subsidiary, today you would either consider the subsidiary the way a public company would have to or you’d have the choice of accounting for your investment on either an equity or cost basis,” Martin says. After deliberating, the decision was made to carry that differential reporting choice forward. “It’s essentially a free choice between the three different methods,” he adds.

Canadian standard setters have said that any private-sector company in Canada, including non-PAEs, can adopt international financial reporting standards (IFRS) if they so choose. There might be situations where a private firm elects to adopt full IFRS instead of the new Canadian GAAP, says Capisciolto, who projects three possible scenarios under which this might occur. One is when a company is planning to become a PAE in the future. “When you go public, you have to deal with three years of statements prepared as if you were a publicly accountable enterprise,” he notes.

Another case may be if the private firm is a subsidiary of a European company that has already adopted full IFRS. “If they were to adopt private company GAAP, they would basically be dealing with multiple reporting environments and have to report to their parent company all the differences.” So it might be more cost effective to just deal with one set of standards and go with IFRS, says Capisciolto. Another circumstance favouring use of IFRS may arise if a private company is very large and in competition with other major PAEs that already report using IFRS or are converting to it. For comparative purposes, the company might also elect to do so if it believes it is adhering to best practices in the industry, he says.

From a logistical standpoint, it is expected that the proposed new GAAP should make life easier for both preparers and users of financial statements. “In talking to our clients, everybody’s very happy that the AcSB is doing this. Accounting standards are getting very complex, and I think it was time to take a step back and look at what is really relevant and understandable to the users of private companies,” says Capisciolto.

Paul Martens, vice-president of finance at The Crossing Co., a firm based in Nisku, Alta., that provides fleets of horizontal directional drilling rigs for oil and gas projects in Canada and the US, agrees that the new Canadian GAAP for private firms will satisfy most of his firm’s operations needs. In the expanding, healthy economy that existed until recently, The Crossing Co. was involved in merger and acquisition activity and putting out financial statements for consideration by bankers and other interested parties that generally only want basic information about the company’s financial health, which can be also obtained from other sources. However, says Martens, with crossborder deals in particular, the possibility always exists his firm will be asked to provide more information than under the new Canadian GAAP, which the company is prepared to do should the need arise.

Kirby Smith, vice-president of finance for Tartan Canada Corp., an Edmonton-based company providing plant maintenance and construction services to the energy, utility and processing industries, agrees that the new Canadian GAAP for financial reporting will serve his company and its stakeholders in a more precise way. Tartan’s major external stakeholder, the bank, is not looking primarily at full disclosures and notes, but more at covenant calculations and key parts of its financial statements, such as senior funded debt over earnings before interest, taxes, depreciation, and amortization, working capital ratio and fixed charge coverage ratio, Smith says.

Jeff Morton, CFO of Piston Ring Service, a wholesale distributor of aftermarket auto parts in Winnipeg, sees the proposed new GAAP as positive in the sense that private businesses tend to have a smaller user group of year-end statements consisting primarily of lenders. When such statements become too complex, “I think readers tend to either stop reading or get a little nervous and pull back,” he says. “They tend to think, ‘I don’t understand it, so I’ll view it negatively.’ So simplicity and clarity are good. I realize that’s tough to achieve in this increasingly complex world we operate our businesses in. But a simplified approach is, I think, more meaningful to the limited number of users who use these sorts of statements.” Moreover, from an administrative standpoint, the simpler and easier they are to prepare, the faster the turnaround, Morton adds.

Tony Chin, CFO of North West Geomatics, a Calgary-based private firm that does digital aerial photography and laser topographical profiling, also views the adoption of the new GAAP for non-PAEs as a favourable move. The administrative and financial costs associated with transitioning to the new IFRS as an alternative to a modified GAAP would have been too onerous, says Chin. North West, whose financial statements are audited despite its private status, currently uses differential reporting options. For instance, it doesn’t have to do future income tax calculations. That doesn’t really serve any useful purpose for most of the company’s stakeholders, which are its private shareholders and the lending financiers, says Chin.

The AcSB has completed its technical deliberations regarding the package of standards for private enterprises, and issued an exposure draft for comment in April 2009. A 90-day comment period will follow with the new GAAP for non-PAEs expected to be finalized and in the Handbook by the end of this year.

“I think that will be an exposure draft people take notice of because there are a lot more private companies than there are public companies in Canada,” Capisciolto says. “This is a pretty important set of standards they’re developing.”

Jeff Buckstein is an Ottawa-based writer.
Paul Dunnett remembers when he first seriously thought about outsourcing some of his firm’s accounting work to India. It was fall 2002 and he was meeting with a US efficiency consultant who was discussing offshoring. Dunnett, the former CEO of Horwath Orenstein, was intrigued. While not completely convinced, he brought the subject up at the firm, where, he says, they all laughed at him. Undaunted, he decided to give it a shot.

That December 2002, the firm sent in a trial batch of 20 personal tax returns with names and personal information blacked out for processing. And with this initiative, he believes, Horwath Orenstein became the first accounting

Photography by GEORGE WHITESIDE

Executives are discovering that offshoring is not just about cost savings, it’s also about freeing staff from the drudge work   By Paul Brent
Outsourcing pioneer: Paul Dunnett remembers initial concerns from staff that people here might lose their jobs.
firm in the country to outsource to India. “They had never seen a Canadian tax return before, and they did a great job,” says Dunnett. The following tax season, the firm sent off 15% to 20% of its individual tax returns for processing, the next year it sent 100% of its individual returns and the following year it began sending over the simplest corporate returns.

The practice of using outside resources to perform activities traditionally handled by internal staff and resources is not new. Companies have hired contractors for particular jobs or to level off peaks and troughs in their workloads for years. In its current form outsourcing has been employed with great success by companies such as General Electric and Procter & Gamble. While the most common reasons to outsource used to be costs or head-count reduction, today the drivers are more strategic and focus on keeping value-added activities in house where an organization can better utilize its own core competencies. Many executives are discovering offshoring is about corporate growth, making better use of skilled staff and even job creation, not just cheap wages abroad. Labour savings from global sourcing may still be substantial, but it’s minor compared to the enormous gains in efficiency and productivity.

For Dunnett and other proponents of offshoring, the benefits of sending work to a place like India are easy to grasp: cost savings, lengthening of the workday by having tasks accomplished while North America is sleeping and, perhaps most compelling, eliminating the need to staff up for the two or three months of year-end or burning out key staff during tax season. But those firms that have resisted the urge to join the offshoring revolution should ask what the risks are to practices that outsource. Are jobs lost? Is staff nervous and unhappy? Do security-conscious clients bolt?

Proponents say that while these questions are legitimate, the challenges can be quickly overcome. “When we started five or six years ago, there was a bit of initial concern from staff in the sense of ‘Am I going to lose my job?’” says Dunnett, now Ontario region managing partner of Meyers Norris Penny since Horwath Orenstein merged in 2008 with the Calgary-based company. While cost savings seem the most immediate benefit of sending work to a lower-cost country such as India, the biggest win is that staff is freed from the annual drudge work and long hours of data preparation that come with tax season. “It means that they are not sitting here doing data input,” says Dunnett. “Staff is not working the same hours during the busy season that friends in other firms do because the work is done for it.”

One of Dunnett’s projects now is to duplicate the successful Horwath experience with outsourcing to the Meyers Norris Penny part of the 2,000-person-strong company. “We laugh about it now that we have done it, but we remember the big mind change. You can’t just walk across your office and see your work being done,” he says. “The sheer fact that your work is being done on the other side of the world is a big mind-set change for accountants.”

Because Dunnett’s company was an outsourcing pioneer and today sends off thousands of personal and corporate returns to India annually, he has had a front-row seat as competitors have tried — and often failed — to follow Horwath’s lead. “A lot of firms will try it, but then because of some little technical challenge will bail out of the whole process,” he says. “I don’t know if that is really because of the technical challenge or because they couldn’t conceptualize the whole thing in the first place.”

MSCM LLP tried and abandoned outsourcing after two tax seasons of sending out a portion of its 10,000 returns. “It think it was mainly on our end that it didn’t work,” says Rosario Suppa, a partner with the Toronto firm. He found MSCM did not have the volume of returns to make the process worthwhile, and although the firm was impressed by the level of knowledge of the Indian preparers, they asked too many nuisance questions. “Inputting of slips is not the major part of the return,” he says. “What we find we encounter a lot here is followup with the client, followup

“The sheer fact that your work is being done on the other side of the world is a big mind-set change for accountants”
When the surf's up, Todd King is there. But because of his schedule neither clients nor staff take second place

Todd Trowbridge's firm took the plunge offshore a few years ago and has outsourced bookkeeping since 2007
Reasons to outsource

Xpitax president Glen Keenan ticks off the reasons accounting firms can benefit from outsourcing

1. The CA profession is aging. That ticking in the background may be the clock on the wall or it could be the countdown to the exodus of thousands of boomer-aged CAs now contemplating retirement. “There isn’t a new, fresh set of people to address the demands that are being put on the profession,” says Keenan. Worse, those boomers will be leaving with decades of hard-earned experience and knowledge.

2. Outsource the boring, less profitable stuff. Firms can hand off the low-yield, compliance work to focus on the value-added (and higher-profit) services such as consulting work, “the services that your clients notice, with the higher billing rates and the most interesting work,” says Keenan.

3. Staff for 12 months, not two. Keenan calls it just-in-time staffing, but the reality is many firms hire staff during tax time they wouldn’t hire any other time of the year and also overwork their key staff during this period, which can lead to burnout and turnover. Rather than hiring for a short-term surge, outsourcing to a place like India lets someone else worry about staffing. (In fact, firms such as Xpitax typically hire people in India a few months before tax time, train them and then redeploy them or let them go over the summer.) “Once they sell you to do personal tax, next they try to sell you other work because they have created the same problem of having a seasonal business,” notes Dunnett, whose firm offshores data-intensive work year round.

4. Forced standardization. Because the outsourcing process is entirely digital, beginning to outsource often forces firms to examine processes that will get rolled out throughout the practice. “That ends up being one of those hidden benefits that many firms don’t think of,” says Keenan.

5. Virtual, not physical growth. Firms can take on more clients, but do not necessarily have to move to new facilities, add computers and staff or worry about client poaching. “It ends up being more of an advantage with our bookkeeping clients,” notes Keenan.

6. Increased turnaround time. With India 10 hours ahead of the East Coast of North America, work sent overnight can be returned the next morning. “There’s tremendous value in having that happen across tax, bookkeeping, and financial services accounting.”

7. It’s cheaper. Xpitax states that outsourcing accounting functions costs roughly half what it does doing it at home (US$10 to US$12 an hour versus US$20 to US$25 an hour), plus firms avoid the hidden litany of payroll taxes, vacations, sick time, benefits, space and equipment costs.

Admittedly there is a cost-reduction aspect to outsourcing, says Dunnett, but there are other benefits. “Clearly, there is money to be saved, and it seems odd coming from an accounting firm, but for us this is not a money thing. We see it as something we need to do to be an employer of choice. We are not doing it for the money.” So how does outsourcing make Dunnett’s firm a coveted place to work? Simple. As tedious tasks such as data input and reconciling are offshored, staff gets to handle challenging, value-added work such as consulting and strategy.

While the drive to outsource accounting is at its heart a people issue — not enough people willing or able to do much of the tax-preparation work in Canada and the US — technology is providing the solution by allowing digital data streams to make time and distance irrelevant. At first the idea that all incoming tax information from clients needs to be converted from paper to electronic versions so it can be accessed by accountants halfway around the world may seem daunting and insecure. But in fact that step can add additional security, says Glen Keenan, president of third-party outsourcing firm Xpitax, which has about 15 Canadian CA firms as clients as well as 300 US accounting firms.

How Xpitax’s service works is simple: all tax files are stored at its ultrasecure, Boston-area data centre. Accountants in India “handle” tax returns only in the most virtual sense. They work on files from screenshots in a sterile setting on the other side of the world and can only access the Boston server from their office’s unique IP address. That keeps out information thieves, no matter where they are located, while it is all but impossible for someone in the Indian outsourcing facility to do anything with the data even if he or she wanted to.

“There is no paper, there are no pencils — it is a completely paperless environment,” says Keenan. “All the security is here. I can say with confidence that the security of our data centre will dwarf any CA firm in the country right up to the big four,” he says. Compared with the security of most CA firms on both sides of the border where offices can be less than secure and people routinely tote around confidential financial information on laptop computers, says Keenan, “we are decreasing risk in more situations than we are not.”

While the issue of security trumps the list of reasons people say that they are wary of outsourcing, Keenan says others include quality concerns, loss of control (and jobs) and potentially unhappy clients.

Keenan, a veteran Deloitte & Touche CPA, started with Xpitax six years ago when it was the experimental side venture of Boston-area firm Kirkland Albrecht & Fredrickson. “It went from
a pet project to a business," he says. Xpitax's former parent firm retains a minority stake in the outsourcer and is one of its best clients. "They outsource bookkeeping work, corporate tax work, and they have done some back-office audit work. This is a firm that made it a mission to be successful and to do things a little bit more cutting-edge than most." And Kirkland Albrecht & Fredrickson claims its revenue has grown by about 50% to about US$19 million today — with the same physical space and the same number of people — by using Xpitax for outsourcing over the past six years.

India has become the go-to destination to outsource accounting work from countries such as the UK and the US because it represents a huge pool of English-speaking top talent. With 140,000 practising chartered accountants and another 350,000 pursuing the designation, according to the Institute of Chartered Accountants of India, a trip to the eastern office will mean a flight to the subcontinent for an increasing number of firms. (By comparison, membership of the Canadian Institute of Chartered Accountants totals about 74,000 chartered accountants and 10,000 students.)

While a comparison of CAs in India to western CAs is like comparing apples to oranges, Dunnett has no complaints with the quality of his Indian partner's work. "They do better input than we do," he says. But his endorsement comes with a caveat. India has to be involved at the start of the process, not midway through. "If I can send them a trial balance and have them produce the financial statement tax return for me, then I see a benefit. But if I can't give them the trial balance, if I am giving them the actual corporate tax return, then the real benefit of what they are doing starts to break down. The real benefit is just the input, not the actual output. Even if they mess up, we still have the value of the input."

2020 Canada, a volunteer membership group for accountants that provides training and services to small and mid-sized accounting firms, has found that those outsourcing to India are largely the mid-sized accounting firms. Most Canadian sole practitioners, meanwhile, just don't want to give up control, says Richard Latimer, 2020 Canada's chief visionary officer. He acknowledges that firms have to be committed to the concept of outsourcing if it is going to be successful. "There is a bit of a process change that you need to do at your firm to accommodate the methodology. If they are not willing to make those accommodations in their process, they may have a difficult time in doing it," Latimer says. "Those that do buy into it would never go back." 2020 Canada advises firms experimenting with outsourcing work to India to do at least 100 tax returns before deciding on the merits of the process. Like some fine wines, not all accounting functions travel well. The list of what not to outsource includes anything that falls under the definition of high-value, high-touch client service. That includes new business consulting, strategic forecasting and budgeting, business valuations, tax planning, corporate financing, business succession, estate planning and wealth management.

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Canadian firms are not required to tell clients they engage in outsourcing, but experts strongly suggest they do

Todd Trowbridge, a principal with the 10-person Toronto firm of Trowbridge Professional Corp., has outsourced bookkeeping since late 2007 and is in its third tax season having returns done by Indian accountants. The firm took the plunge following a presentation on the potential benefits of offshoring.

“It’s worked out quite well, and more so on the bookkeeping side,” says Trowbridge. He has found that the regular contact and reporting required in its bookkeeping practice is ideal for outsourcing. “Because they are involved throughout the year, I think they have a much better idea of what is happening with a client, whereas with a tax return they are doing that once a year and it may not necessarily be the same person working on the file."

Trowbridge is cautiously embracing tax outsourcing: about 20% of his clients’ returns were processed by the firm’s Indian partners last year and there is no hard target for the current tax year. What remains in Canada is the complex tax work that the firm is reluctant to have done by a third party. “We do a lot of Canadian-US and expat returns, which some of them may struggle with. They are quite a bit more complex,” says Trowbridge. “With a straight Canadian or US return, they would generally be pretty good.”

The firm does not advertise that it is sending work overseas, but it does make clients aware that it engages in third-party outsourcing either locally or overseas in its engagement letter. “You get the odd client who will ask or be curious. But for the most part they trust you are looking after their best interests.”

Outsourcing experts do advise firms, however, to tell clients they engage in outsourcing. “You want to disclose it to your clients,” advises Keenan. He encourages firms to explain to their clients either verbally or in writing that outsourcing of lower-level work is being done so that the firm can focus on higher-value tasks such as consulting and tax planning.

“You will have a handful of people who for some reason say no. That’s fine, you won’t send those returns.”

In Canada, firms are not required to tell clients that they are outsourcing their accounting work. “But we strongly suggest it,” says Peggy Tyers, president of 2020 Professional Corp., has found that the benefits are readily apparent in the efficiency of its engagement letter. “You get the odd client who will ask or be curious. But for the most part they trust you are looking after their best interests.”

For Trowbridge, the most obvious benefit of outsourcing is time. “Going back to the bookkeeping side, we had a lot of trouble finding qualified bookkeepers to service our clients,” he says. “If we could not find anybody, we were stuck doing it ourselves and we just didn’t find we could do it very efficiently. Any good bookkeepers we found were completely booked because they were good.”

When it came to adding bookkeeping clients the firm was constrained, but now through India it is able to offer bookkeeping to its current roster of clients. “We had only one bookkeeper we were happy with and there were too many clients for one person to handle all the data entry,” Trowbridge says. “I felt she could manage many more clients if she was only required to review and respond to questions from the outsource team, and this has turned out very well with outsourcing.” It has transformed bookkeeping from a service the firm was reluctant to offer to more clients to a modest money-maker.

Trowbridge had made the shift to a digital operating environment shortly before its linkup with India. “We had converted to a paperless environment just before we started outsourcing the first tax returns, so we were ahead of the game,” he says. “By the time we had started bookkeeping we were already completely paperless, at least from our clients’ point of view. We were already scanning everything, although going paperless is a big process and it’s somewhat costly.”

The big four accounting firms also looked to India as a place to alleviate the shortage of qualified accounting and advisory people in North America and Europe. They have established their own offices on the subcontinent.

For firms looking offshore, the ability to bulk up at peak season and the cost savings from skilled people willing to work for less than North American wages may have been two of the drivers to India and other low-cost countries. While the savings are not as great as many firms might have expected, firms such as Horwath Orenstein and Trowbridge Professional Corp. have found that the benefits are readily apparent in the efficiency of their operations.
The advisory panel’s recommendations on Canada’s international taxation focus on a simpler, fairer system

On December 10, 2008, the advisory panel on Canada’s system of international taxation released its final report and recommendations to the Minister of Finance. Although the panel was officially struck by the Minister on November 30, 2007, its creation dates back to the Department of Finance anti-tax-haven initiative introduced May 14, 2007, following the controversy of the March 19, 2007 federal budget. Both the anti-tax-haven initiative and 2007 federal budget contained the controversial proposal to restrict the deductibility of interest and other expenses incurred by corporations resident in Canada in relation to their investments in foreign affiliates, as well as certain other international tax measures. Somewhat ironically, this panel recommended the restrictions on interest deductibility be repealed.

The panel’s mandate was to recommend ways to improve the competitiveness, efficiency and fairness of Canada’s system of international taxation that could help guide the Minister in establishing an international tax policy framework with respect to investment abroad by Canadian businesses, as well as investment into Canada by foreign businesses. Unlike the 1997 Committee on Business Taxation (the Mintz committee), whose recommendations needed to be revenue neutral, this panel had no such restriction.

The panel’s recommendations reflect an overall focus on the development of a simpler, fairer and more efficient system that improves the competitiveness of Canadian companies. In a relatively short period of time, the panel produced a well-written and sensible report, characterized by a pragmatic rather than a dogmatic approach, as well as cautious refinements rather than sweeping reforms, and to date, the recommendations have been generally well received by the business and investment communities.

In its report, the panel made the following principal recommendations:

**Taxation of outbound direct investment**
- The current exemption system applicable to dividends paid to Canadian-resident corporations by foreign affiliates out of their treaty-country active business income should be expanded, within limits.
- The exemption system should be extended to apply to dividends paid out of all active business income and should not be dependent on the residence of the foreign affiliate or the source of the income being in a country with which Canada has concluded a comprehensive income tax convention or a tax information exchange agreement, including an amnesty in many cases for existing undistributed taxable surplus.
- The exemption system should not be extended at this time to active business in...
The general thrust of the system should be retained.

- The exemption system should be extended to apply to capital gains derived by Canadian-resident corporations from the disposition of shares of foreign affiliates where all or substantially all of the property of the foreign affiliates is excluded property (i.e., essentially, active business assets).

The panel’s recommendations are generally aimed at reducing the complexity and compliance burden for taxpayers and the Canada Revenue Agency associated with tracking surplus account balances. In addition, the panel is of the view that precluding Canadian businesses from benefiting from exempt surplus treatment with respect to active business income earned in a nontreaty or nontax information exchange agreement country is inappropriate. As for extending the exemption system to capital gains derived from the sale of foreign affiliate shares that qualify as excluded property, the panel is of the view that doing so would be appropriate as the affiliate’s income would also be exempt from tax in Canada and would also be consistent with the approach adopted by other countries with an exemption-type regime. Finally, it is the view of the panel that its recommendations would likely be revenue neutral as dividends from foreign affiliates and capital gains realized on the disposition of foreign affiliate shares rarely give rise to tax under the current regime.

Interest and other expenses
- In general, no new restrictions should be introduced on the deductibility of Canadian-resident corporations of interest and other expenses incurred by them in relation to their investments in foreign affiliates.
- The restrictions introduced after the 2007 federal budget with effect after 2011 on the deductibility of expenses incurred by Canadian-resident corporations for the purposes of funding interaffiliate loans resulting in double-dip income (Section 18.2 of the Income Tax Act) should be repealed.
- The deductibility of such expenses could be restricted by refined thin-capitalization rules and targeted anti-avoidance rules aimed at debt-dumping arrangements.

Without a doubt, this area attracted the most attention as it caused the most controversy following the 2007 federal budget. In recommending an outright repeal of Section 18.2, the panel was of the view that Canada’s tax system should not create any disadvantages for Canadian businesses when they attempt to compete abroad and that Canadian businesses require flexibility in raising capital and structuring the financing for their foreign operations if they wish to compete on level ground with businesses based in other countries, particularly in light of the current global financial environment.

Passive income and the foreign accrual property income rules
- The general thrust of the system should be retained.
- The current rules applicable to recharacterizing interaffiliate payments and certain other items as “income from an active business” should be retained.
- Certain of the current rules (the base erosion rules and investment business rules), which can apply to recharacterize what would otherwise be active business income as income from a business other than an active business or as income from property, and therefore possibly as foreign accrual property income, should be reviewed to ensure they are properly targeted and do not impede bona fide business transactions and the competitiveness of Canadian businesses.
- However, the base erosion rules that target income derived from Canadian debt obligations, Canadian leasing activities and the insurance of Canadian risks should be retained.
- The characterization of a foreign affiliate’s income as foreign accrual property income should not be affected by whether or not it is derived from a source in a country with which Canada has concluded a comprehensive income tax convention or a tax information exchange agreement.
- The currently proposed amendments concerning nonresident trusts and foreign investment entities should be reconsidered.

The recommendations are aimed at reducing the complexity and compliance burden for taxpayers and the CRA associated with tracking surplus account balances and better integrated with the foreign accrual property income rules.

While the panel’s recommendations regarding passive income and the foreign accrual property income rules are generally regarded as being noncontroversial and to a large extent somewhat expected, they should be congratulated for recommending a review of the base erosion rules to ensure that they are properly targeted and do not impede bona fide business transactions affecting the global competitiveness of Canadian businesses, particularly in light of an increasingly global supply chain for most Canadian multinationals.

Taxation of inbound direct investment
- The general thrust of the current thin-capitalization rules (applicable to restrict the deductibility of interest on outstanding debts to specified nonresidents) should be retained, but the rules should be refined.
- The permitted debt-to-equity should be reduced from 2:1 to 1.5:1.
- However, the scope of the rules should not be extended to affect third-party debts that are merely guaranteed by (as opposed to owing to) specified nonresidents.
- The scope of the rules (currently applicable only to Canadian-resident corporations) should be extended to partnerships, trusts and Canadian branches of nonresident corporations.
- Further refinements should be considered, such as the possibility of treating any disallowed interest expense as a dividend for purposes of imposing Canadian withholding tax on the pay-
ments, as well as the possibility of introducing targeted anti-avoidance rules aimed at back-to-back loans made through third-party lenders.

• The introduction of targeted anti-avoidance rules aimed at debt-dumping arrangements involving Canadian-resident corporations that are foreign controlled should be considered.

• Such rules could operate either by restricting the deductibility of interest and other expenses or by imposing immediate Canadian taxation at withholding tax rates on the relevant transaction amounts.

• Preferred share investments made by Canadian-resident corporations in foreign sister companies may give rise to the greatest concern, but the applicability of such rules in respect of investments in other equity interests should not be excluded.

• No specific measures should be introduced to address treaty shopping, as the panel believes businesses should be able to organize their affairs to obtain access to treaty benefits.

• Further reductions in withholding taxes should be considered — bilaterally, in future tax treaties and protocols to the extent permitted by the government’s fiscal framework and its agenda regarding additional corporate tax rate reductions.

The panel’s recommendations regarding the taxation of inbound direct investment were to a large extent expected, particularly its recommendation to extend the thin-capitalization rules beyond Canadian-resident corporations and its focus on so-called debt-dumping arrangements. The panel’s recommendation to reduce the permitted debt-to-equity from 2:1 to 1.5:1 (without restricting the use of third-party debt or guaranteed debt) was generally based on a desire to not increase the complexity (by introducing an arm’s-length approach or earnings stripping rules) of the rules and the compliance burden on Canadian businesses, and to reduce the permitted debt-to-equity ratio to a level that the panel believes is more closely in line with actual Canadian industry ratios and the ratio permitted in other countries (that generally also apply the rules to third-party and guaranteed debt).

As noted, the panel’s report has generally been well accepted. As part of the January 27, 2009 federal budget, the government indicated it is currently studying the report’s recommendations and will provide a response in due course; however, it is interesting to note that the most significant recommendation of the panel (the repeal of Section 18.2) was contained as part of the budget proposals and received Royal Assent on March 12, 2009.

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Determining damages

When damages include compensation for lost future profits after the date of adjudication (lost future profits), it is essential to apply an appropriate discount to those future profits in order to determine their current value. To do so, a philosophy is needed to determine the appropriate discount rate.

To the date of adjudication, damages are determined retrospectively, with hindsight being integral to the calculation. The actual historical results reflect the playing out of all relevant risks and market conditions of those times. Since one must reflect what took place between the date of the incident at which the damage period begins (referred to herein as the date of breach or incident) and the date of adjudication, computing past lost profit damages for the period prior to the date of adjudication obviously does not require projections or application of net present value concepts. One can legitimately use what would otherwise be hindsight information.

Determination of the present value (or principal amount) of lost future profits must reflect certain execution risks, market risks and the time value of money but not the general risks of running an overall business or the risk of not winning revenue equal to the very revenue stream at issue. (Farley Cohen and Prem Lobo presented an excellent paper, “Establishing a discount rate in a litigation context,” at the Canadian Institute of Chartered Business Valuators’ regional conference in Quebec City on September 5, 2008. It is very informative and addresses the same topic from a different perspective.) This stream is much more certain than general future business revenues as it has been determined by the court to be that which otherwise would have accrued to the plaintiff.

Determination of the principal amount of lost future profits is generally done using what are referred to herein as (1) the specific projection method; or (2) the discounted projection method. Application of both methods should yield a similar result and, if employed concurrently, one provides a sanity check on the other. However, the avail-

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RISK-ADJUSTED FUTURE PROFIT

The present value of this stream is determined using a discount rate reflecting the risk of the particular business and the forecast horizon. The discount rate is the rate at which one reduces future cash flows to reflect their present value.

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PRESENT VALUE OF NET PROFIT OVER FIVE YEARS

The present value of the future losses is calculated using the discount rate for each period and the corresponding profit. The result is the net present value (NPV) of the losses, which represents the current value of the future losses.
ability of data may permit the application of only the discounted projection method.

The resulting damages represent an amount that, if the plaintiff invested that amount in a risk-free bond over the period of the future loss, would yield the same net present value (NPV) as the lost future profits themselves after adjusting them for all the specific risks of realization.

The two methods of determining lost future profits are:

Specific projection method
But-for analysis is the amount in nominal dollars of (i) the probability-adjusted profit that the plaintiff would most likely have enjoyed but for the incident (PBF), less (ii) the probability-adjusted profit the plaintiff most likely anticipates earning (P*).

Both P* and PBF have embedded in them the effects of the anticipated real world risks, including industry risk, execution risk and the myriad of risks that conventionally accompany the business activities in question. The risks as they actually play out (R) may be similar but not necessarily the same as those in the but-for world (RBF). For example, the but-for world will not reflect the effects of the incident, while the anticipated results fully reflect them. PBF has embedded in it all the risks inherent in the hypothetical but-for world assumptions, RBF.

In order to convert the but-for profit (PBF), which is a nominal dollar amount, into the appropriate sum to be paid at the date of trial, it needs to be discounted at a rate modestly greater than the risk-free rate of return — say, Government of Canada bond rate plus something modest. This rate will vary inversely with the risk already reflected in the but-for profit. The more risk already inherent in those profits, the lower the discount rate and vice versa.

Except in very rare cases, the pure risk-free rate will be too low. Determination of the increment, albeit modest, can only be done having regard for a full appreciation of the risks factored into the but-for profits projected using the specific projection method. If that stream was sufficiently conservative, then the premium would predominantly reflect unanticipatable internal and external factors — and there always are some.

As we have defined PBF, all the known risks have been reflected, on a probability-adjusted basis, in that stream of profits. If the rate were too high and included an element of profit or further risk, this would unfairly punish the plaintiff and deny much of the very profit to which the plaintiff is entitled. The effect of the higher rate would inure to the benefit of the defendant who would have less damages to pay.

Purchase-price allocation is a new discipline. It requires business valuers to value all the assets of any newly acquired business, including customer relationships, customer contracts and all other identifiable intangible property. Essential to this process is the determination of appropriate discount rates in the valuation of these assets. These very discount rates will provide significant objective evidence and guidance in applying the specific projection method. The rate chosen will be above a risk-free rate and significantly lower than the weighted cost of capital — often akin to the same rate that is being applied to the profits emanating from contracts in place on an acquisition, ignoring any credit risk.

In summary, the specific projection method is a conventional discounted cash flow method where the risks are built into the figures and not the discount rate; and it examines a range of scenarios before settling on a sufficiently narrow range to assist the court. It conceptually, if not practically, employs Monte Carlo simulation modeling, which is a problem-solving technique used to approximate the probability of certain outcomes by running multiple trials, called simulations, using random variables. It requires what-if analysis in the determination of P* after adjudication and in PBF.

Discounted projection method
An alternative to the specific projection method, the discounted projection method is a conventional discounted cash flow method where the risks are built into the discount rate. It is a much less granular approach. It does not address the impact of the risks on any item in the cash flow projection. Rather,
profits to ensure no double counting or omission of risk.

The specific factors one would consider in DRPA as compared with DRBF will be reflective of the effects of the breach/incident, mitigation and cessation of the activities in question.

The discount rate would not reflect the risks of running an overall business or being successful, at law, in recovering the very revenue stream at issue. There is a risk that the discount rate will be overstated. The overstatement would come from inadvertently giving too much weight to the factors noted below. They are too general and while relevant considerations, they are only of indirect relevance and require very selective use:

• equity risk premium — the general incremental return required over the risk-free rate to compensate for the risk of equity investing as opposed to buying a government bond;
• weighted average cost of capital of the harmed company and its competitors;
• hurdle rates used by management in assessing whether to accept projects with similar risk characteristics;
• business risk associated with lack of diversification in terms of products and/or geographic locations, key man or customer dependence — except to the extent that the ability to produce the revenue stream at issue is put at risk or the marginal rate of profits is affected by same.

The chart on page 37 demonstrates the large underestimation of the post-adjudication profit component of damages if too high a discount rate is used. That is, if the rate is 20% versus 6%, the damages are $1 million less over a five-year period — $4.3 million versus $3.3 million.

What does all this mean? Where you are able and there is adequate information, specifically assessing the business reality of the plaintiff and preparing a detailed, risk adjusted financial projection is the most desirable method.

However, there will be many occasions when this is not possible. In these cases, making the best projection you can, and then applying a carefully constructed discount rate (discounted projection method) can get you within the generally correct ballpark — about the same place as with the specific projection method. Once the contentious gross revenue stream is determined with a high level of confidence, care needs to be taken to ensure that the related future profits after the date of adjudication are not undervalued by overstating the discount rate. That is to say, what the court giveth, the discount rate should not take away.

Stephen Cole, FCA, FCBV, is a partner at Cole & Partners, a Toronto-based corporate financial adviser and chartered business valuator. He is also Technical editor for Business valuation.

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Do you really need it?

A new network can have significant benefits for your organization, but only if you first determine that it’s a strategic fit.

Your IT department has come up with a new business network for you to review. The head of IT claims it will improve speed and reliability and set the stage for convergence — the ability to run voice, data and video on one powerful network.

It sounds promising, but is it just another expensive, short-lived IT project that has more technical than business value? Does your existing network, which works fine, really need to evolve toward convergence?

Supporting business communications

Businesses can’t operate without the ability to communicate. Employees communicate with one another, with customers and suppliers using voice, e-mail, instant chat and video conferencing. And employees communicate with information and applications running on the network, including accounting systems and scheduling systems. They also access information outside the network on the Internet.

For employees to be productive, all communication — voice, data or video — must be reliable and seamless. So the network technology supporting communication should contribute to and drive that productivity.

In addition to communication requirements, security is a major priority. Information residing on and travelling across the network must be protected to ensure its integrity. This is especially critical for businesses that have remote locations, are geographically dispersed, support teleworkers or operate multinationally.

Currently, many companies rely on two separate networks: one to support voice communications and one to support data communications. While this approach works, it does not deliver optimum business or technology value. With two networks, companies must duplicate equipment, maintenance, management and support. There is also the complexity of managing two supplier relationships with different service level agreements.

Keeping up with change

The rapid evolution of telecommunications during the past 10 years and the shortage of qualified IT personnel have pushed many organizations to consider data network redesign to meet changing business requirements, such as security. With organic network growth, the proliferation of redundancy leads to high capital expenses and complexity. And while it is possible to maintain high availability, the cost of doing so is prohibitive.

An alternative is to consider a new, converged network that delivers significant benefits over a traditional network environment.
of applications and branch data centres can expose the network to security risks. Then there are cost considerations. Maintaining both a voice and data network is expensive in terms of personnel and maintenance.

While companies were grappling with how to handle new and more demanding network requirements, telecommunications providers were undertaking major network upgrades to transition to next-generation Internet protocol (IP) networks to support an Internet-reliant business world. With upgraded network infrastructures, telcos could leverage the opportunities inherent in convergence more effectively by providing one integrated platform for voice, data, video and wireless traffic.

With the network upgrades complete, telcos could support their customers’ network redesign requirements and offer a reliable path to convergence through multiprotocol label switching (MPLS).

What is MPLS?
MPLS is a protocol, which means it sits on top of existing access methods and manages traffic more efficiently by assigning priorities to voice, data, video and other traffic. With quality of service (QoS) tagging, administrators can determine how voice, data and video should travel across the network. QoS is critical for convergence because it ensures performance. Information travels across the network seamlessly based on what is most important to your business and communication requirements.

It’s similar to traffic on a highway. There are all types of traffic — police cars, ambulances and passenger cars. When there is an accident, the emergency vehicles get priority over the rest of the traffic. MPLS does the same thing for communications. It ensures that the most important traffic passes quickly across the network while keeping the rest of the traffic safe.

To better understand how MPLS works in a business environment, examine its capabilities based on a potential real-world example. A firm with five North American branch offices maintains two small data centres at two different locations for redundancy purposes. A majority of voice calls are interoffice, resulting in significant long-distances charges. Users access key applications, including an in-house inventory management system, and use PeopleSoft remotely. Currently, the company runs two separate networks for voice and data.

In an effort to unify communications, the company implements an MPLS network and achieves a single data network for voice and data traffic; the ability to prioritize traffic; and long-distance and maintenance cost savings.

New technology, new capabilities
One of the key advantages of a MPLS network is the type of applications that can run on it. With QoS capabilities, you can implement many types of applications, prioritize their importance across the network and, as a result, gain a host of new capabilities for business productivity.

Voice, video conferencing, database information sharing, customer relationship management programs and collaboration software can all run on an MPLS network. The advantage is that the company can prioritize what is important. No longer will a YouTube download slow down an important database update. Traffic can be shaped to meet the needs of your business.

Business benefits of convergence
Convergence is more than a technology term or a way to route traffic more effectively across your business network. It is a strategic way to deliver value to your business. Embracing convergence enables you to: Improve flexibility — with an MPLS network in place, you can take advantage of IP innovation in voice, data and video applications. You also have the ability to tailor your network to your business needs and expand it as your business grows.
Integrate new productivity applications — by building your network using industry standards and best practices, it is easy to integrate new applications and capabilities. You can have IP telephony and IP video running on the same network to target productivity improvements.

Reduce costs — with one network, you can minimize capital investments in equipment and infrastructure and cut operational costs. Most providers also offer managed network solutions so you can rely on their expertise and investments, reallocating precious resources to value-added business activities.

Enhance security and reliability — MPLS networks support optimum security and QoS prioritizes the traffic to ensure peak performance.

Easy scalability — the technology foundation of an MPLS network makes it simple to connect sites to the network and reduces the management complexity.

Is MPLS right for you?

Adopting new network technology is a serious undertaking. Before pursuing a change, evaluate your business to determine if MPLS can deliver significant benefits.

Is your company multisite or single site? If you only have one location, you may not need MPLS. You may simply require more efficient network planning. Even with two sites, you should consider carefully whether the cost savings warrant a migration.

Do you have users trying to access programs, databases and applications over wide areas? If yes, then MPLS may be a cost-effective and efficient solution. Are you running mission critical applications? If so, MPLS can support timely, reliable access.

Are your long-distance costs high as a result of interoffice communications? If so, these can be virtually eliminated using MPLS. Is your IT staff facing challenges in maintaining your current network? If so, outsourcing this function through MPLS is a good solution.

If you have built a fairly convincing business case for MPLS, there are still a few more things to consider: with falling long-distance rates, there may not be much savings as a result of implementing MPLS. The cost of traditional access methods for both voice and data is falling significantly as a result of increased competition in the marketplace. The savings from MPLS may be limited and, in some cases, you may be better off with network status quo.

There are other network solutions that may meet your needs including ATM networks or Frame Relay. ATM and Frame Relay are also efficient data transmission techniques that use different protocols than MPLS to send voice and data traffic. Given that they were developed before MPLS, MPLS has taken into consideration the good and bad in both these protocols. It is important to consider what you have deployed in making the move to MPLS. If you currently have Frame Relay or ATM consider the remaining life of those networks. Although they are widely deployed, these networks are getting antiquated but are still worth consideration.

Depending on your business and how you interact with customers (i.e. Internet-based customer care), it may be prudent to evolve your network to the latest technologies.

Choosing an MPLS service provider

A number of service providers offer MPLS solutions. Keep in mind that MPLS is a protocol. Because it rides on top of existing access methods, providers can buy the underlying access from incumbent telcos and then layer their MPLS solution on top. These are considered value-added resellers. They offer MPLS solutions. Typically, they purchase the MPLS network from a carrier for resale. Their value add is twofold. First, they are likely providing a critical application or are managing the applications on your network. Second, they have the expertise to deal with the telco in getting your service provisioned and managed. In addition, given that they manage the service for numerous customers, they can pass volume discounts onto you.

In this case, your relationship is with the resellers, even though they are not the underlying service provider. Make sure

Adopting new network technology is a serious undertaking. Before pursuing a change, evaluate your business to determine if MPLS can deliver benefits

the reseller is a viable business with longevity and that the middle man will not impede delivery and fault resolution time. If you have in-house expertise, it may be more beneficial to partner directly with the telco.

All major telcos offer MPLS services and the advantages of network access, national reach, financial stability and expertise. They will be able to assemble a team dedicated to your business and ensure the solution is tailored to your specific needs.

If you choose to deploy an MPLS network, you are entrusting your network and, in essence, your business to your service provider. It is critical that the company you choose has the business and technical resources to deliver, manage and maintain the solution according to your business priorities.

With careful planning and evaluation, implementing an MPLS network can have significant benefits for your organization in terms of efficiency, reliability, cost reduction and security. So when IT comes to you with the concept of migrating to a new network to support convergence, you’ll be able to have an informed discussion about the business and technical value to determine if it’s a strategic fit for your organization.

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A dose of humility

In 2008, my stock portfolio, which I manage myself, lost 45% of its value. Since I had made average annualized gains of 18% from 1998 to 2007, I thought I was a pretty good investor. But 2008 forced me to face a harsh reality.

My only consolation is that I am not the only one whose portfolio value dropped significantly. Millions of houses of cards came tumbling down last year, not only for amateurs such as myself but also for professionals. The best investment theories failed the test in 2008, unless they had been totally off the mark in the previous bullish years.

No doubt some investors posted positive returns in 2008. But do not confuse success with luck. I was lucky in the years 1998 to 2007, before I came crashing back to earth. The same could be said for most investors, who had not grasped the extent of the market crash or the misunderstood global economic crisis. Of course there are the experts who claim they saw it coming. In fact, every year a bestseller announces one global catastrophe or another. A dog that never stops barking will bark every hour on the hour. But it still can’t tell the time.

However, there is one person who was less mistaken. A Franco-American mathematician born in Poland in 1924, Benoît Mandelbrot studied mathematics in France and in the late 1950s immigrated to the US. The inventor of fractal mathematics, he believes markets are much less stable than economists claim because they are periodically affected by major fluctuations. Based on impressive empirical analyses, he questions the hypothesis that financial market fluctuations follow a Gaussian (or normal) distribution, i.e. the famous bell curve. His data indicate that markets are structurally subject to rare but violent fluctuations that are reflected by an infinite variance — a premise that Gaussian distribution dismisses. In rejecting the Gaussian model, Mandelbrot negates most of the models used in modern finance, such as the capital asset pricing model and the Black-Scholes formula.

For a better understanding of Mandelbrot’s approach, read The (Mis) Behavior of Markets: A Fractal View of Risk, Ruin and Reward, published in 2004.

Mandelbrot’s theory has a growing number of supporters. In 2007, Nassim Nicholas Taleb, a former student of Mandelbrot, popularized it in The Black Swan: The Impact of the Highly Improbable, which maintains that quite a few phenomena beyond financial markets don’t follow Gaussian rules. From time to time, a black swan emerges, to borrow Taleb’s image, precipitating a crisis for which we are not prepared.

Overturning 50 years of financial market theory, from Harry Markowitz’s efficient portfolio theory to the Black-Scholes formula, and invalidating the work of several Nobel Prize winners does not happen overnight. Most economists and professional investors still rely on archaic Gaussian-based models. So it is not surprising that many experts and specialists lost huge sums on the market.

Mandelbrot teaches us to have humility when it comes to assessing phenomena we think we understand. The usual rules for managing the economy and guiding investment decisions are based on flawed theories, unrealistic in today’s world. But merely admitting the limits of our understanding of the current crisis will not restore investor confidence.

How can we kick-start an economy in a society where key players realize they have lost their bearings and have cautiously retreated to a holding position? In such an environment, economics has to give way to psychology. As was the case during the Great Depression, it will take more than an injection of funds into the financial system to get the economy moving. We have to instil confidence and help people forget that times are tough. Economics won’t boost the markets — what we need is faith.

Marcel Côté is founding partner at SECOR Consulting in Montreal.
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