OUR annual Personal Financial PLANNING issue

Even in this age of disappearing pensions, you can plan for a well-funded retirement.
Here are the options...

- Get cash for life P. 28
- Keeping count at the dance school P. 10
- Changing rules leads list of issues P. 11
- New standards aim to meet demands P. 41
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Defining pensions

Pension plans are a tricky proposition in the age of prolonged recessions and declining investments. What’s the right option?

Pension plans are probably not going away soon in Canada despite such bad news as the reported record growth of defined benefit (DB) liabilities around the world. A survey published in September by the International Foundation of Employee Benefit Plans found that employers in Canada are still committed to providing benefits that help employees plan a better retirement. The survey also found that about 56% of employers in Canada offer a DB plan with a guaranteed monthly income.

Thus it remains important that people thinking about retirement consider all the DB options given that they are notoriously complex and difficult to understand, especially with the federal and provincial legislation under which they are administered.

In “Defining benefits” (p. 20), Patrick Longhurst tackles the issues involved: he discusses a three-step process that has been developed to help anyone considering retirement to look at his or her pension arrangements. First, he says, you must fully understand the choices available; then you should compare yourself to the average plan member to see how this might influence your decision; then consider the overall context in which your decision is being made. Even then, he reminds readers, “there are very few slam dunks.”

In “Cash for life” (p. 28), Peter J. Merrick speaks to the other half of employees who may not have access to company pensions due to the recent decline of these retirement arrangements. He points out that while GICs may be useful to such potential retirees, they do not generate sufficient cash flow to fund retirement goals. Merrick reports that annuities — legal contracts that guarantee the purchase fixed payments for a lifetime or a specified number of years — will do that much better. “There are many permutations of annuities,” he says, “and they can be combined to create a matrix of benefits tailored to a client’s particular objectives.”

Both features are part of our annual Personal Financial Planning issue, and many readers will find in them useful information that illuminates the sometimes opaque matter of planning for retirement.

In this issue, Netwatch columnist Jim Carroll discusses the jobless recovery, and how people attuned to the impact of Internet trends on the economy knew this was coming (p. 16). The ever-popular and controversial Marcel Côté lambastes Prime Minister Stephen Harper for failing to promote policies favoured by economists despite being the first economist PM in this country. Economist Côté looks at the GST cuts and the StatsCan controversy, and says Harper’s policies are disturbing to his fellow economists. In addition, there are Regulars on fraud (p. 36), standards (p. 41) and legal issues (p. 44).
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Defined benefit pension plans are complex. And for anyone considering retirement or about to make a decision concerning his or her pension arrangements, he or she must first fully understand the choices available and the implications of those choices.

BY PATRICK LONGHURST

28 Cash for life
With their guaranteed payments and tax advantages, annuities are becoming a major component of retirement and estate planning in the US, with billions of dollars flooding into these products. So why aren't annuities as popular in Canada?

BY PETER J. MERRICK
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Breaking news, tax updates, job postings, archives, more articles: you’ll find them all at www.CAmagazine.com
THANK GOODNESS IT’S NOT 1961

Regarding the Fraser Institute’s comment about the increase in taxation between 1961 and 2009 in “Tax blast from the past” (Bits & Bites, August), the snippet shows the tax burden on the average family increased to 41.7% from 33.5%. Scary. Note, however, that food, clothing, housing and tax totalled 90% in 1961 and 78.8% in 2009, so I’d say we’re better off now.

If medical expenses had been included in the 1961 numbers they would have been even worse. Between 1961 and 2009 we’ve had increased social security, Canada Pension and universal healthcare added to the government’s list of expensive services.

The only negatives to this increased tax burden are that the Fraser Institute has a bigger cudgel with which to beat government, that tax evasion in the underground cash economy has become more lucrative and the rewards for aggressive tax planning have increased.

Ron Fast, CA
Ancaster, Ont.

MISSING POINTS

“Can audit committees deliver?” (Education, September) misses the point. In a very limited way, it measures the effectiveness of the audit committee.

The study indicates that there is a positive association (57%) between independence of the member and effectiveness. Its conclusion is based on the definition “the absence of relationships that may interfere with the exercise of a member’s independence from management or the company.” The study does not consider the most critical requirement: the need for independent thinking and the ability to be outspoken and critical when challenged by events. I have witnessed members listed as related to management being the most outspoken and challenging, while members who met the definition of independence sat silent.

While 55% of respondents indicated that there was a positive association between financial expertise and the audit committee’s effectiveness, the survey did not emphasize the need for knowledge and understanding of the oversight role of the committee.

The article, which lists five attributes to determine if members have the financial expertise necessary to meet the definition of financial literacy, places “understanding of audit committee functions” fifth. In my experience, the need to understand the mandate that governs the functioning of the committee is as critical as independence and financial literacy.

A lack of understanding of the mandate, which defines the role of the committee member, can create a difficult working relationship between members and management. There must be a clear understanding of the role that members play and how it differs from that of management and the external auditors.

With the need for experienced and well-trained CAs to fill the many positions on the ever-increasing number of audit committees, it would have been useful if the survey had emphasized the requirements mentioned above.

Ronald Singer, FCA
Westmount, Que.

Authors’ reply:
We deliberately limited our analysis to research (published in academic journals from 1994 to 2008) on audit committee characteristics subject to regulation by the...
Canadian Securities Administrators (independence, competencies and number of members). The objective was to examine from a broad perspective the effectiveness of the regulations related to these characteristics. We acknowledge that some critical elements are missing. As indicated in the last paragraph of the article, “an implicit assumption behind the composition and resource requirements is that through some processes, members will be collectively able to accomplish their monitoring task.”

The article gives a brief summary of 15 years of research on audit committees, where almost all studies examined characteristics of the audit committee that can be regulated and are (to some extent) visible by outsiders. In the International Journal of Auditing article, on which our article is predicated, we provide a more comprehensive discussion of audit committee effectiveness and call for future research into aspects of the audit committee that have not been thoroughly investigated until now. However, academics cannot investigate these other aspects by reading information circulars.

Researchers need to talk to audit committee members and better observe audit committees in action, during regular meetings. Such research requires access to audit committees and we encourage chartered accountants involved in audit committees to participate in such research when contacted.

MORE ON INVESTING

In “Invest like the pros” (Personal financial planning, September), while the author makes a number of references to risk, in my opinion, there is no such thing as a risk-free investment — only risks the investor can sleep with.

For example, a GIC or bond may yield 4% and the dollar value guaranteed by the federal government. However, net after...
Mailbox

income tax, the yield is a maximum of 3%, approximately the rate of inflation, so 3% of the purchasing power of the principal is approximately offset by the income; therefore, the true yield is nil even though the dollars are guaranteed.

I believe that the asset mix has to be adjusted for market conditions. For example, currently interest rates are unusually low, and interest income attracts the top rate of income tax paid by the investor. I would therefore suggest that the asset mix be shifted to blue chip equities and preferred shares. If interest rates go to 10%, I would recommend the mix be shifted toward income bearing securities.

The investor must have specific criteria for his or her investments. For my own equity investments I request the following from my investment advisers:
- all Canadian investments must have a market capitalization of not less than $500 million, US$1 billion;
- current market price and 12-month trading range and the range in the most recent month. I usually buy on an uptick and am most interested in equities that are in the lower quartile of their trading range;
- all equity investments must pay a dividend and I request the yield;
- the EPS and book value per share – EPS/BV=return on investment (ROI). I believe that a sustainable ROI should be no more than 15% to 20%;
- the EPS must be greater than the dividend in order to ensure that dividends will continue; and
- a target price and a time frame (e.g., $50 by the end of 2010). If an investment market price drops 10%, I consider selling it.

When I receive a list of equities that meet these criteria, I select a few that are in different market segments. I then call my investment adviser and ask, Do you trust the company's management? Does the company do what it says it is going to do? What is its track record? If the replies are not positive, it is not an investment.

My adviser's responsibility is to know the market, mine is to know what I can sleep with. With specific criteria, my adviser is aware of what investments I believe will achieve my goals and will call me when he becomes aware of an investment I may be interested in. He also calls when one of my investments no longer meets my criteria.

David Cowan, CA
Edmonton

Author's reply:
I agree with your comments; specifically, that a well-designed portfolio needs to address all risks including the risk of inflation, deflation, currency, etc.

I also agree with the comments regarding asset mix. From time to time, it makes sense to make tactical shifts to the lower or higher end of the strategic asset allo-
According to Hayward, the decision to invest and maintain our own ERP, we went back to the roots of the idea. "We used other ERP packages, and we were particularly strong in mining and waste-water treatment, but we also work with a wide variety of process industries: chemical processing, food processing, pulp and paper – the list is extensive, even the automotive industry needs pumps for paint."

As a result of the company's mining specialization, Hayward Gordon has established a growing global presence. "The company as a whole is very strong in North America," says Hayward, "but we're also exporting a good deal of equipment to South America and other parts of the world. We currently have projects destined for countries such as Madagascar, Australia, Dominican Republic, Mexico and Chile."

In 1990, Hayward Gordon decided to run its operations on SYSPRO enterprise resource planning (ERP) software. "We went through a number of false starts before settling on SYSPRO," says Hayward. "We used other ERP packages, and even tried to make one ourselves. When we realized what an immense task it would be to create and maintain our own ERP, we went back to the market, and eventually chose SYSPRO."

According to Hayward, the decision to invest in SYSPRO was based on three main considerations. "First off, the work we do is highly varied – we're more of a job shop than build-to-stock. We felt that SYSPRO's Bill of Materials (BOM), Work in Progress (WIP), and Requirements Planning modules lent themselves well to a job-shop environment. Secondly, SYSPRO's integration of operations and finance was excellent – far better than anything else we looked at. Finally, we wanted to be sure that the ERP we chose would be properly maintained and supported. Many of the ERP companies we considered had then disappeared, and SYSPRO had stayed, and has supported its product very well."

Over the last few years, says Hayward, the company has faced a major challenge – the strengthening of the Canadian dollar. "That's put immense pressure on us to become more productive, and to reduce our costs," says Hayward. In response, the company has been implementing LEAN practices. "That has a lot to do with leveraging our ERP. We underwent a very extensive business-process mapping project, a few years back, to find areas in which we could create efficiencies, and many of the ways we chose to streamline our business involve the use of SYSPRO."

For example, Hayward Gordon has implemented electronic time tracking in the shop, and has automated its labour posting function. "We get the tracking in real time now," says Hayward, "and by having SYSPRO do it, we've been able to eliminate a data entry position. We've also integrated Microsoft CRM (customer relationships management) directly into SYSPRO, thereby automating our order entry. Now we can have people in the field enter their orders automatically, eliminating the need for duplicate entry."

In the near future, says Hayward, the company is hoping to implement electronic funds transfer (EFT) to streamline its payables. "The timing for all these efficiencies has been good, because despite the market challenges, we've been seeing some growth. Getting more out of SYSPRO has allowed us to expand without breaking apart at the seams."

Leveraging SYSPRO has not only reduced costs, it has helped Hayward Gordon reliably meet its lead times. "One of the things we realized," says Hayward, "was that we had to compress our lead times and make them more reliable. We've taken a number of steps that take advantage of the fact that processes that used to run consecutively, can now run concurrently. For example, these days, when an order is entered, it gets reviewed and the credit check is triggered along with a customer number request -- all electronically and all at the same time. Previously, a paper file would spend many days travelling to multiple departments for approval before the order was placed. Now, if there's a problem with the order, action can be taken right away. It's much more efficient, and it's helping us serve our customers better."

Asked to comment on SYSPRO's ROI, Hayward offers a useful metric. "We've seen our revenue per employee increase by around sixty-five percent in the last four years. You can't do that unless you build into your company the ability to grow sales without growing costs in lockstep. If you don't have the right infrastructure in place, your sales can even cost more to make than they're worth. That's what productivity is about – if you have the right systems in place it gives your company extra capacity, without adding costs. That's the way we've been able to measure what SYSPRO has done for us."

Says Hayward, in conclusion: "We're very happy with SYSPRO: the product, the support, and the ongoing development. The fact that we've been with it as long as we have says a lot. We continue to build it into our operations in a very important way."

To find out more about Hayward Gordon, please visit: www.haywardgordon.com
cation for a particular asset class. The key here is to make these changes according to an investment strategy that is laid out in an investment policy statement. If the shifts are made according to the written plan then they are not emotional responses, and it is the emotional response that causes problems.

The criteria on which you base an investment decision are sensible and if this strategy is followed with discipline, there is no doubt the results will be above-average performance. The problem for most investors, in my experience, is that they do none of the things that you mention nor do they ask these questions. Unfortunately, investors are not encouraged to do this type of homework.

You are one of the rare investors who will (over the long term) outperform, compared with 99% of the population (including financial advisers), most of whom do not follow any strategy.

TOUGH ARTICLE TO FOLLOW

“Look boss, no hardware!” by Dwayne Bragonier (September) was very difficult to follow. It is a subject we need to maintain a current understanding of and yet paragraphs such as the following left me confused:

“Virtualization is the separation of the physical hardware layer from the operating system layer. It involves running a machine that doesn’t physically exist. That’s why the virtual machine is on the top of the list of breakthrough evolutionary ideas concerning software. Of course, there is some hardware necessary, but it is not dedicated to any one virtual machine.”

What on earth is he talking about?
Can someone write an article on this subject using language that ordinary people can understand?

John Telfer, CA
Parksville, BC
ONE FOR THE ROAD

Given the ability to download the Income Tax Act onto an iPad (“Income Tax Act now available in all formats,” Upfront, September), CAmagazine should consider having the magazine in ePub format, as it would be nice to download and read it on an iPad. Even if the entire magazine were available as a PDF, it is relatively easy to convert to ePub and then download to an iPad.

Glen Demke, CA
Edmonton

Editor’s reply: While we are looking into making CAmagazine available to mobile devices, it is possible to read CAmagazine.com on your mobile device.

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As a dance instructor at The School of Dance in Ottawa, Kateri Jacobs typically needs to count only as high as eight. But the 27-year-old CA also juggles much larger figures as arts administrator for the school, a non-profit charitable educational organization with a $900,000-plus budget.

Jacobs’ fascination with dance started early. “My mother tells me how I tried to follow along in my playpen while she did dance aerobics,” she says. At age six, Jacobs began studying ballet, followed later by modern, jazz and hip hop. By age 12, she started taking dance more seriously, entering — and often winning — national and US competitions.

After high school, Jacobs completed one year of a contemporary dance training program at The School of Dance but when she developed hip tendonitis she began to think of a career as a dance teacher. Having always found math easy and fun, she chose to study business at university and taught dance on the side. Upon graduating, she landed a position at Ernst & Young in Toronto but later transferred to the Ottawa office to enroll in a two-year teacher-training program at The School of Dance while pursuing her CA designation.

Today, she teaches everything from creative movement for kids ages four and up to intermediate ballet for adults, in addition to handling the school’s big-picture finances, such as budgets and grant applications. She also performs occasionally. During a summer event in Ottawa called Dancing in the Streets, Jacobs and other dancers from the school improvised performances around the city. While she enjoys performing, Jacobs finds teaching fulfilling too. “I get great satisfaction when kids are happy doing what they’re doing. And I’m glad that I’m able to share my love of dance with others.”

Angela Pirisi

Keeping count

Communication is key as IFRS deadline looms

Financial executives may have some ‘splainin’ to do. More than a quarter of Canadian companies anticipate a decrease in reported net income as a result of the conversion to international financial reporting standards in January, according to a Canadian Financial Executives Research Foundation study.

Furthermore, 22% of companies expect earnings per share to fall and 28% expect an increase in pension liabilities in the first year of adoption of IFRS. But just 23% of companies have spoken to analysts about the potential impact of IFRS on their company’s financial results.

“Companies will need to spend more time communicating the key changes,” says Michael Conway, CEO and national president of FEI Canada. “The numbers, formats and notes that analysts and shareholders will see on financial statements will change and CFOs will have to make communication their priority.”

Résumé

2006 joins Ernst & Young, Toronto
2009 obtains CA designation (Ont.)
2009 begins teaching full-time, The School of Dance, Ottawa
2010 completes two-year dance-teacher training

Ottawa CA Kateri Jacobs teaches children and adults at The School of Dance, where she is also arts administrator

Ottawa CA Kateri Jacobs teaches children and adults at The School of Dance, where she is also arts administrator
Keeping up with regulatory changes remains the top challenge facing accountants in industry, according to the Canadian results of the 2010 International Innovation Network Members in Industry Survey, conducted among accountants from seven accounting associations around the world. This finding is consistent with the Canadian results from the benchmark survey conducted in 2007.

Managing staff was next on the list of challenges, as it was in 2007, followed by motivating staff, which was not asked on the 2007 survey. One item that dropped off the list in 2010 was staff retention/minimizing staff turnover. This suggests issues related to staff management are about keeping staff motivated in a challenging economic environment.

Implementing internal control and/or risk management systems and measuring financial performance also remained high on the list but both were down slightly from 2007. Reporting on nonfinancial performance and implementing new accounting standards increased slightly and both were top challenges for just more than half of members in industry, as was cost cutting, which was added as an option in 2007.

Business development was a challenge for 44% of respondents, up from 37% in 2007. Hiring CAs (24%) and other business professionals (33%) were less likely to be challenges, down 8% and 7% respectively. All three of these changes were likely influenced by the economic downturn.

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

### I LOSE ENERGY LATE IN THE DAY. HOW CAN I AVOID THE AFTERNOON SLUMP?

All professionals experience lulls in productivity. High-performing individuals are typically attuned to their most productive times of the day and, when possible, schedule their critical tasks during those hours. Here are a few tips to keep your energy levels up and maximize your productivity:

**Switch gears.** If you’re struggling to focus, take a quick break and research something new. Changing tasks can help increase your productivity late in the day.

**Plan ahead.** Don’t put off challenging projects until the end of the day, when your energy may wane. Use your less-energetic periods to catch up on routine tasks, such as responding to e-mails and reading industry publications.

**Eat well.** Remember to make time for lunch and nutritious snacks throughout your workday. Avoid high-carb foods, which can cause you to crash later.

**Get out and smell the roses.** If you feel your energy beginning to dip, stretch or take a short walk to recharge. Try eating your meals or holding afternoon meetings outside.

**Track goals.** Keep a to-do list to remain focused and ensure it’s visible on your desk so you can check items off as they’re completed. There’s nothing more motivating than making progress on your projects.

Max Messmer is chairman of Accountemps (www.accountemps.com) and author of Managing Your Career for Dummies.
1. Rank of Canadian mutual funds among 18 countries for the highest management fees. "Canada," noted the 2007 Harvard University study, "is the single-highest fee country by far."

2.52 Percentage fee paid by clients for managing the average Canadian equity fund in 2009.

10 Dollars in billions paid in investment fees by Canadian mutual fund holders in 2002. The total was up 357% from $2.8 billion in 1995.

14 Percentage of hedge funds that don’t disclose performance fees for managers, according to a study by Toronto-based Investor Economics.

20 Dollars out of 100 accounted for by hidden investment fees in clients’ accounts, according to a 2007 article by fiduciary risk expert Robert Pouliot. An earlier poll found 65% of Canadian investors didn’t believe they paid hidden fees.

84 Percentage of Canadian mutual fund investors “at least somewhat comfortable” with the fees they paid, according to a 2006 investment industry poll. The survey also found most purchasers wanted less information about their investments.

100 Additional percentage charged in fees to manage funds by US financial companies, compared with public employee pension plans, according to one recent study. The pension funds paid out six times the value on average. —Steve Brooton

**Fees statement** A 2010 survey of affluent Canadian investors found 47% incorrectly believed they paid no fees to manage their mutual funds. Our prospectus on investment fees:

**Going Concern**

**Leon Goren, CA, President, Presidents of Enterprising Organizations Inc.**

**Company Profile:** Headed by the former president and CEO of Just White Shirts, Leon Goren, PEO is a leadership development company. Its motto, “connect, think, grow,” sums up its goal of empowering executives to achieve their personal goals while helping companies improve performance and ensure sustainable growth. Members attend monthly meetings led by an executive adviser offering a safe environment for tough discussions that can take members out of their comfort zone. Mutual trust drives the proceedings; members may seek business insights at one session and offer them up at another. Peer pressure ensures advice is carried out rather than ignored. Annual fees of $6,000 to $15,000 also cover at least two one-on-one meetings with the adviser and an annual two-day retreat. About 40% of PEO’s 100 members are from large multinationals; the rest are entrepreneurs from smaller firms.

**HOT FACTOR:** As the economy begins to recover, PEO is trying to expand leadership development beyond presidents and CEOs. By breaking down the silos within organizations, it hopes to introduce new ways for other executives to learn and grow.

**Cool Projects:** PEO has launched a 12-month leadership development program focused on creating greater corporate value. With the aid of an executive adviser who is present at the company, the program focuses on having the senior executive team engage in conversations in an environment where open discussion is encouraged. The initiative’s guiding principle is “when leaders stop learning, their organizations stop growing.”

**In His Own Words:** "Entrepreneurs and other leaders are very bright, committed people. One piece of advice we offer them is to let employees finish their sentences before speaking up. Allowing more ‘give and take’ rather than cutting them off makes a huge difference. Change takes time because it involves people.” —Ken Mark
SALARY INCREASES RETURN

Canadian employers are projecting average base pay increases of 2.9% for 2011, according to Mercer's latest Compensation Planning survey. Based on responses from more than 600 employers in Canada, the report indicates that only 2% of companies expect to freeze salaries for 2011, down from 6% in 2010.

F FOR FINANCES

Six in 10 university students expect to graduate with debt and 74% don’t use a budget, finds an RBC/Ipsos Reid poll. In addition, just half (52%) regularly monitor where their money is going and two-thirds (66%) feel that worrying about money will have an impact on their grades.

WHERE TO BE AN HEIR

Alberta is a great place to be if you are planning to leave an inheritance to your children. According to PricewaterhouseCoopers' annual Tax Facts and Figures, probate fees in Alberta are $400, regardless of the value of the estate. That's about nine times less than the national average of more than $3,500.

Top body language mistakes, according to hiring managers

<table>
<thead>
<tr>
<th>Activity</th>
<th>% who said it would make them less likely to hire a job candidate</th>
</tr>
</thead>
<tbody>
<tr>
<td>No eye contact</td>
<td>87%</td>
</tr>
<tr>
<td>Lack of smile</td>
<td>38%</td>
</tr>
<tr>
<td>Fidgeting too much</td>
<td>33%</td>
</tr>
<tr>
<td>Bad posture</td>
<td>33%</td>
</tr>
<tr>
<td>Weak handshake</td>
<td>26%</td>
</tr>
<tr>
<td>Crossing arms over chest</td>
<td>21%</td>
</tr>
<tr>
<td>Playing with hair/touching face</td>
<td>21%</td>
</tr>
<tr>
<td>Using too many hand gestures</td>
<td>9%</td>
</tr>
</tbody>
</table>

Source: CareerBuilder, 2010

Most find meaning in work

As many as 75% of employees find their work to be meaningful, according to a poll from human resource firm Right Management. In the poll of 1,000 North American workers, 42% said they always find their work meaningful, 35% said they usually do and 16% occasionally do. Only 5% of respondents said they rarely or never find meaning in their work.

Interestingly, the survey findings varied with job type, age and size of company. Sales professionals were most likely to always find meaning in their work (47%), while consultants were least likely with just 25% citing always. Four in 10 (41%) workers aged 25 to 34 said they always find meaning in their work but 28% of those 55 or older do. Similarly, 42% of employees at small and medium-sized firms always find their work meaningful, compared with 36% at large firms.
It pays to plan

Canadians who have engaged in comprehensive, integrated financial planning feel more optimistic about their emotional and financial well-being than those who have not, a new study says. They are also far ahead of those who seek only limited, piecemeal advice.

The Value of Financial Planning study represents the first phase of a five-year longitudinal study commissioned by Financial Planning Standards Council (FPSC) and conducted by The Strategic Counsel. It compares three groups of Canadians: those who have received comprehensive, integrated financial planning, those who have had limited financial advice and those who have done no financial planning. Comprehensive planning was defined as that in which the respondent’s main financial adviser has provided financial planning for major life goals and events, or at least three financial planning components. Limited planning was defined as engaging in just one or two components. The results were analyzed separately for varying net worth categories (i.e., less than $100k, $100k to $350k, $350k to $600k and more than $600k) and were designed to eliminate net worth as an influencing variable while evaluating the impact of financial planning.

In all, the study points to the value of comprehensive, integrated financial planning — for all net worth groups. It points out that a full 61% of respondents with comprehensive planning think they will be satisfied with their financial situation in retirement compared with only 46% with limited advice and 27% with no financial planning. Those who have done a comprehensive plan also feel better prepared to deal with financial emergencies and manage through difficult economic times and are more confident about reaching a wide spectrum of life goals. In addition, they are more apt to save regularly for the things they value, such as retirement, education and home ownership, and for discretionary spending such as travel and leisure. Here are some of the responses from those with comprehensive plans:

• I am closer to achieving some of my life goals as a result of financial planning (71%);
• financial planning has helped me increase my net worth (70%); and
• because of financial planning, I worry less about money (59%).

“The research provides conclusive evidence that those engaged in comprehensive, integrated planning have a far more positive outlook regarding their financial affairs, especially with regard to their longer-term financial well-being,” says Cary List, CA, CFP, president and CEO of FPSC. “ Undertaking ad hoc, or limited financial advice, while clearly better than nothing, just doesn’t have the same impact as taking a comprehensive view of how to best manage one’s finances to meet your life goals. And those who are doing no planning at all are being left far behind.”

The results also indicated that advisers who provide comprehensive, integrated financial planning tend to have stronger, more deep-seeded relationships with their clients than those providing limited financial advice. These relationships are characterized by higher levels of engagement.

For an expanded article in which List expands on the survey findings, please visit www.CAmagazine.com/FPSCstudy2010.
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The future has arrived

As the global economy sputters back to life, the media is all abuzz about the “jobless recovery,” reporting that contract positions are taking the place of full-time jobs. But this should not come as a surprise to those who understood the full impact the Internet would have on the economy over time.

In 1997 I wrote a now-out-of-print book called *Surviving the Information Age*, which included a long-term view of workplace trends. In one chapter, I observed that a wired world means people no longer have to live close to their workplace; that location was quickly becoming irrelevant.

I went on to offer a number of other predictions about the future of the workforce. Looking back today, some of them were bang on and mimic the trends we are seeing as the jobless recovery unfolds. Let’s revisit them to see just how accurate my prognostications were:

**Full-time jobs will begin to shrink dramatically** It used to be that companies entered into an employer-employee relationship to access some type of specialized skill or knowledge. If a company needed a new marketing specialist, it hired one. Then came the recession of the early 1990s. With the onslaught of restructuring, companies came to appreciate that it cost a lot of money to fire people as severance packages had become expensive. A new way of thinking in the corporate world built on this logic: if we hire staff, we might have to fire them some day, particularly if we have another recession. It costs a lot of money to fire people. So why not hire people on contract or as temporary workers? The role of the wired world? A lot of those workers are found on the end of a telecommunications line.

**Companies will hire the best talent, regardless of where they might be** In the wired world, the only thing that counts is knowledge. If the knowledge is accessible from anywhere in the world, then companies will be able to choose the best talent and expertise they need from a group of global, skilled consultants. The impact? A new era of career competitiveness is about to unfold as a number of highly skilled workers sell their capabilities and talents to a global audience of business organizations. Marginal performance will no longer be good enough: in the new dog-eat-dog world of networked business, the old rule that those with the best skills and capabilities will be in the greatest demand will be even more true than it is today.

**Lifestyle choice will dominate career decisions** Because they can supply their skills from anywhere through the tools of the wired world, this elite group of individuals will call the shots. They will make lifestyle decisions that will let them service their national and global clients from a rural electronic cottage, thus enjoying the fruits of the wired economy, while at the same time watching their children grow up. More people will choose to work from the places they want to, rather than where they have to.

**A generational battle for economic control is upon us** Our economic systems are increasingly characterized by baby boomers and the older generation, who are now faced with a wired and technically sophisticated generation X. Increasingly, economic survival depends upon mastery of technology, and it should be obvious who has the upper hand in this game.

Maybe I was right about those trends. But my view of the future wasn’t flawless: I also predicted there would be fewer people working in downtown office towers as companies relied more on outside expertise. I wrote: “The real estate industry has a phrase for this: ‘see through buildings.’ That’s because they will be.” Funny, there still seems to be quite a few people downtown.

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

**The jobless recovery**


“The contingent workforce,” BusinessWeek.com  www.businessweek.com/careers/content/may2007/ca20070523_580432.htm
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CICA launches e-commerce site

This month, a new e-commerce site promises to improve your experience when shopping online for CICA publications, conferences and courses. CAstore.ca has been specifically designed to facilitate online purchases and course registrations. The introduction of this site allows CICA’s knotia.ca site to focus exclusively on its role as a leading research hub for the accounting profession.

“Members and customers told us that it was confusing to have a store and a research site at the same online address,” says Brian Loney, director of publishing, member services. “So we separated them and took the opportunity to simplify and improve customers’ online shopping experience. We’ve retooled and updated the CAstore so it reflects the CA brand and now includes conferences that the CICA presents throughout the year. The store’s fresh, new direction makes it easier to find and buy CICA’s popular tax and accounting products,” says Loney.

The knotia.ca site will remain CICA’s online research platform with its popular subscription-based databases that are available for purchase at CAstore.ca along with more than 1,300 print books, e-books, DVDs, e-mail newsletters and conferences.

“Customers can feel confident in making purchases at the CAstore. Transactions are secure and seamless, driven by industry-leading technology. Searching for products is easier than before,” says Loney. “Enhancing the customer experience was paramount to this exercise and I think we’ve achieved that — I hope our clientele agree.”

The CAstore can be found at CAstore.ca and the knotia research site at knotia.ca.

Exploring new directions in accounting education

This is a time of unprecedented change in Canadian accounting and assurance standards. How accounting educators can best respond to these changes is the subject of a symposium — Leveraging Change: New Pillars of Accounting Education — co-sponsored by the CICA, University of Toronto and the CA/ Rotman Centre for Innovation in Accounting Education. Every Canadian university with an accredited undergraduate program in accounting has been invited to participate.

“The objective of this symposium is to use this extraordinary period of change in the accounting standards body of knowledge as an opportunity to rethink how we teach accounting,” says Tim Forristal, CICA’s vice-president, education. “We want to bring leading thinkers and interested academics together to explore future directions in accounting education and its evolution in the next decade.”

The symposium takes place November 22 at the Metro Toronto Convention Centre.

CICA conference to bring environmental issues into better focus

Environmental, social and governance (ESG) factors are playing an increasing role in today’s business world. Corporate leaders, senior management and business advisers must prepare for a wide range of new risks, opportunities and strategies.

To assist with that preparation, the Canadian Institute of Chartered Accountants (CICA) is hosting its first-ever conference on ESG issues December 6 to 7 in Toronto.

“A primary focus will be the financial implications of environmental issues, including climate change,” says Frank Colantonio, CICA’s director of continuing education. “The conference will serve as a catalyst for practical dialogue on how to best confront the changing landscape facing Canadian business leaders.”

Environmental innovations can lead to important new business opportunities. Institutional investors and others are looking for corporate disclosures that currently go beyond what is provided in financial reporting. Governments are paying more attention to greenhouse gas emissions. Environmental failures can impact global supply chains and reputations resulting in financial losses and tarnished brands.

“There is value in drawing together diverse voices that are addressing environmental risks and opportunities,” says Colantonio. “Collective knowledge and experience often tip the scales in favour of positive performance.”

More information is available online (www.cpd.cica.ca/ESGIssues/about.cfm).
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Anyone considering retirement or making a decision regarding a defined benefit plan should understand the choices available and their implications.

Defining benefits

by Patrick Longhurst

George had worked 35 years for the same employer. Throughout that period, he contributed to the corporate defined benefit (DB) pension plan, amassing a pension worth $1 million by the time of his retirement. Then one day this year he made a decision that would affect the rest of his life. George decided to take this pension as a lump sum rather than as a series of guaranteed payments.

Had George fully understood the tax investment and value implications...
of this action, his decisions might have been different. As it was, he got advice from all sides and had no real frame of reference to guide him. But there is a process that could have helped not only George but the millions of Canadians like him who have pension decisions to make.

DB pension plans provide a defined level of pension on retirement, death, employment termination or disability. The pension is typically based on a formula involving earnings and years of participation in the plan. DB plan documents are complex, made more so by the combination of federal and provincial legislation under which the plans are administered. The plans are also subject to Canada Revenue Agency limits and are designed to reinforce the sponsor’s human resource strategies, which may include integration of the plan benefits with those payable under government programs; subsidization of certain early retirement options to encourage individuals with long service to retire before age 65; and provision of phased retirement rules to allow plan members to ease into retirement over a period of years.

To help anyone considering retirement or about to make a major decision concerning his or her pension arrangements, a three-step process has been developed. First you must fully understand the choices available to you and the implications of those. Next, compare yourself to the average plan member and see how this might influence your decision. Then, consider the overall context in which the decision is being made.

Even with this process, there are few slam dunks. Most often the analysis suggests an optimum strategy based on the balance of probabilities. Sometimes the options are just too close to call, and the individual has to fall back on gut feel.

Step 1 — Identifying the available options
DB pension plans are notoriously hard to understand. Even the words used in the option forms that members receive are arcane. Expressions such as vested, locked-in, commuted value and normal form mean something to a pension professional but not to the general population.

For example, many pension plans include a five- or 10-year guarantee on payments made in retirement. A five-year guarantee means the pension is payable for the lifetime of the member and is guaranteed to be paid for the first five years. If the member dies after only 12 monthly payments have been received, the balance of the 48 guaranteed payments will be paid to the member’s beneficiary or estate. People have mistakenly believed a five-year guarantee implies the pension is only payable for five years and then ceases in any event or that the five-year guarantee starts after the member’s death.

A clear understanding of each expression and the deals being offered is paramount, as is understanding the implications. For

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The Financial Services Commission of Ontario website, www.fsco.gov.on.ca, has a lot of information on pensions, including an excellent glossary. Some pension terms of note:

**Committed value** — the amount of a lump-sum payment payable today that is estimated to be equal in value to a future series of pension payments.

**Locked-in retirement account (LIRA)** — a particular form of a registered retirement savings plan offered by financial institutions. A LIRA is used to hold money that is transferred out of a pension plan when a member terminates employment. LIRAs are governed by the Pensions Benefits Act and the federal Income Tax Act. Often referred to as a locked-in RRSP.

**Life income fund (LIF)** — a particular form of registered retirement income fund offered by financial institutions. A LIF may be purchased with money transferred out of a pension plan when a member terminates employment. A LIF is used to provide a regular retirement income and is subject to minimum and maximum annual income payment limits. LIFs are governed by the Pensions Benefits Act and the federal Income Tax Act.

**Locking in** — a legislative requirement that vested pension benefits be used only for the purpose of providing a retirement income. Also applies to LIFs, LIRAs and locked-in retirement income funds.

**Vested benefits (vesting)** — benefits to which a pension plan member or former member is entitled unconditionally under a pension plan as a result of satisfying age or service requirements.
example, under some plans, the eligibility for certain post-retirement health and dental benefits can be conditional on the form of benefit selected by the plan member.

There may also be tax implications. In a recent client situation, the individual was a member of a DB pension plan that was being converted to defined contribution (DC). Under this type of plan, the employer (and possibly employee) contributions are known and the benefit payable will depend on the amount of the accumulated contributions at retirement. Members aged 50 and over were given the choice of remaining in the existing DB plan or moving to the new DC plan. This was not just a case of understanding the plan terms and projecting the pension payable under both options. The choice of plan designs also affected the amount of the annual pension adjustment (PA), which in turn drove the available RRSP room for each member. This was an important implication that could easily have been overlooked.

Step 2 — The unique client versus the average member
Many DB pension choices depend on an actuarial calculation. Frequently, these calculations are performed on a standard actuarial basis to ensure that the options are cost neutral to the plan. For example, many plans provide a series of optional payment forms at retirement. The normal form might be a pension payable for the member’s life with a 60% survivor pension payable to the spouse. An optional form might be a reduced pension payable for the member’s life with a 100% survivor pension payable to the spouse. The amount of the reduction would have been calculated to ensure actuarial equivalence. The point is this equivalence is established on a macro basis. Suppose the member is aware that he or she has a medical condition that is likely to reduce his or her life expectancy. Such a situation increases the attractiveness of the 100% survivor option.

More broadly, actuarial equivalence may include assumptions covering:
· the mortality of both the member and the spouse/partner;
· future salary increases of the member;
· future rates of return;
· future rates of inflation;
· the probability that the member will have a spouse/partner at retirement;
· the expected age difference of the member and the spouse/partner; and
· the expected age at retirement of the member.

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Every person is unique and this may expose a positive or negative factor relative to the broad actuarial assumptions. Many of the large public sector plans include the opportunity to buy back periods of eligible past service not currently credited for the member under the plan. As a member ages, these buy-backs become increasingly expensive. An analysis of the basis used for the calculations relative to an understanding of the client’s actual expectations helps to identify the pros and cons of the buy-back. For example:

- the member has a family history of below-average longevity — con
- the member expects a major salary increase next year — pro
- the member has a spouse who is four years younger — pro
- the member does not want to retire until age 65 — con

The obvious flaw in this approach is that the actual best option in any situation will only be known at the end of the day following the death of the member and any other potential beneficiaries. However, as in many other aspects of life, decisions should be based on the most likely outcomes, using the best information available at the time.

Step 3 — The pension decision as part of an overall strategy
Context in deliberations is most important. First and foremost, what are people planning for the rest of their lives? Do they expect to work full or part time after retiring from their current careers? Will they need a high level of guaranteed income to support their lifestyle? How important is the creation of an estate? These are fundamental issues that can outweigh other financial considerations.

Second, what are their attitudes to investing? Are they going to be able to sleep at night (remember 2008) knowing their investment decisions will have a critical impact on the level of their future income? Are they likely to be so conservative in their investing that they will be unable to obtain a rate of return that supports the option they have elected?

But more broadly, what is going on in their lives that could affect their decision? For example, do they have major registered or nonregistered investments, independent of the pension plan? Does their spouse or partner have a pension or other sources of income? Do they have major obligations for a mortgage or line of credit? Do they have special events they can anticipate that will involve major cash outlays?

Every issue may have some implication for the decision at hand. The key is to listen and learn. There are no rules of thumb that can be generally applied and the affected individual must make the decision, as only he or she can weigh the soft issue trade-offs. Expected longevity is often a key issue and is the hardest to quantify.

These days there is one further item of context — the financial status of the pension plan. Take General Motors and Nortel, which the daily papers reported on, as examples and it’s not surprising that some plan members are nervous that their pension plans will not be able to pay out promised benefits. This could influence employees to favour an immediate lump-sum payout. For reassurance as to the stability of a company’s plan one could look to recent filings with the provincial or federal government, clues from the sponsor’s financial statement, and any website that is devoted to the plan in question. Ultimately, any assurance is not definitive, however, plan members should also beware of any scaremongers who may have a financial interest in the decision.

A case study
Looking at George’s scenario, the basic facts are that George, the pension plan member, and his wife, Linda, both aged 58, expect to live until age 85. George is retiring this year and would be happy to work part time to age 65. He is entitled to a commuted value of $1 million, payable 55% as a transfer to a locked-in retirement account (LIRA) and 45% as taxable cash or he is entitled to a lifetime pension of $50,000. Assume a benefit accumulation formula of 2% a year times 25 years of service times best five years of salary ($100,000) equals $50,000 a year, continuing at 60% to the spouse (should he predecease her) and fully indexed to increases in the consumer price index (CPI). If he takes the pension, he is also entitled to post-retirement health and dental benefits.

Linda works part time and earns $10,000 a year. She does not belong to a pension plan. They do not have any RRSPs or nonregistered investments. They will both be entitled to full Old Age Security at age 65. He will be entitled to full Canada Pension Plan at age 65 and she to a partial CPP benefit.

They require $40,000 cash a year to live on. They own their home, which has a market value of $300,000, and have a mortgage of $100,000. They want to know which pension option George should take.

One financial planner advised him to take the commuted value, pay off the mortgage and invest the rest. George is also worried about the financial stability of the pension plan.

With the three-step process
Historical arguments for taking a lifetime pension include: you have a guaranteed income for life; your spouse receives an income if you die prematurely; and you are protected against inflation.

Arguments for taking a commuted value are you have control over the investment of the assets; you have more flexibility over the payouts; and you could have assets remaining after you and your spouse have died, which could become a part of your estate.

**DB pension plans:**

- The pension payable on retirement is defined by a formula, typically based on the years of credited service in the plan and on pensionable earnings close to retirement.
- These plans may or may not require member contributions in addition to the employer-required contribution, which is calculated on a regular basis by the plan actuary.
- The plan will also provide benefits on early and postponed retirement, or on the death or disability of the member.
- The specifics of these benefits are set out in the pension plan document and communicated to the plan members through a member booklet.
Step 1
The two options facing George are pretty clear. What about the implications?

If he takes the lifetime pension option, because the pension is being paid from a DB plan, he will be immediately eligible for pension income splitting. Given Linda's low level of income, he can use this to significantly reduce their taxes payable.

If George takes the commuted value, there is a key issue that only 55% is eligible for a rollover into a LIRA. This happens because Canada Revenue Agency has set maximum value factors for transfers from registered pension plans. The maximum value at the member’s age of 58 is $11 per $1 of pension, as prescribed in Income Tax Regulation 8517. The fact that the commuted value factor is almost double this is a result of both current low rates of interest, which affect the interest basis for the commuted value, and the pension being fully indexed and having a 60% spousal feature, which makes it more valuable.

When the LIRA is converted into a life income fund (LIF) at some point in the future, recent Ontario legislation provides that up to 50% can be transferred into an RRSP and essentially be unlocked. However, LIF payments, or any RRIF payments, will only be eligible for pension income splitting at age 65.

The other major implication is by taking the commuted value, George loses his eligibility for the employer's post-retirement health and dental benefits. These benefits can have a value of at least $5,000 a year.

Step 2
There is nothing particularly remarkable about George and Linda. Probably, the main issue for him is that he is eligible to retire...
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under the rules of the plan with an unreduced pension.

If the full commuted value of $1 million were to be transferred to a LIRA, George would require an annual rate of return of 5.5% a year after expenses and before tax to duplicate the payments under the pension plan. This assumes life expectancies of age 85 and a 3% annual rate of inflation. The 5.5% annual return is quite a reasonable target for a balanced fund.

However, in this case, George would have $550,000 transferred into a LIRA and approximately $243,000 of nonregistered investments after tax. To reproduce the payments of $4,166.67 a month ($50,000 a year), after adjusting for the tax differences between income from registered or nonregistered sources, would require an annual rate of return of 7.5% after investment expenses and before income tax. This is a far more difficult target than the 5.5% return.

Overall you have to ask, why pay more than $200,000 in tax now, when you could take a pension and pay almost no tax in retirement?

**Step 3**
The most obvious item of context in this case is that the pension benefit is almost the only asset the couple has. A wrong decision in this case could have disastrous results.

The couple could live on the lifetime pension plus part-time income, plus government benefits, and have enough left over to pay down the mortgage fairly quickly. Any spare cash they would accumulate should be invested in their tax-free savings accounts.

A key question relative to the commuted value is how would George feel about having to invest the best part of $1 million? If the risks required to obtain an aggressive rate of return would leave him with sleepless nights, then there is a clear message.

Another important item of context is the financial status of the pension plan. Is there a real risk of the plan not being able to pay out the promised pension in the future?

If a risk exists, it is a strong argument for taking the commuted value. In this case, the pension plan is in the public sector and the risk of default seems to be slight.

Finally, there is the realm of behavioral finance. Many individuals tend to over-value a lump sum relative to a stream of income. If George has this bias, it is important to be aware of it.

**Conclusion**
This is the information that George has to base his decision on. What difference would it make if he had a wealthy spouse, or if he also had $500,000 in RRSPs? What would you do in this case? What would it require for you to take the commuted value?

Patrick Longhurst, CFP, is with Longhurst & Jack Inc., which provides independent lifestyle and financial advice to clients approaching retirement.

For more information go to www.longhurstandjack.ca
According to Statistics Canada, more than a third of working Canadians will reach retirement age (60+) within the next 10 years. Most of them are responsible for funding their own retirements, thanks to the decline and disappearance of company pensions, and many are wary of the stock market due to recent volatility. Investors looking for more stable sources of retirement income might consider a simple portfolio of GICs.

Illustration by SETH
Annuities are becoming a major component of retirement and estate planning in the US: billions of dollars are flooding into these products. So why aren’t annuities as popular here in Canada, considering their preferential tax treatment and rate of return?

but, while this might let them sleep at night, it will likely not generate sufficient after-tax cash flow to fund their retirement goals.

Enter the annuity. Annuities are legal contracts or agreements that guarantee the purchaser, or annuitant, fixed payments on an investment for a lifetime or for a specified number of years. These payments are generally not subject to the same level of taxation as other sources of retirement income and, depending on the type of annuity, may be protected from creditors in the event of insolvency or lawsuit. There are many different permutations of annuities and they can be combined to create a matrix of benefits tailored to a client’s particular objectives.

It’s not surprising then that annuities are becoming a major component of retirement and estate planning in the US, with billions of dollars flooding into these products. So why aren’t annuities as popular in Canada, considering their preferential tax treatment and rate of return?

Domestic fee structures could be to blame. In the US, advisers who sell annuities earn up to a 10% commission on the gross deposits into an annuity, while the average initial commission earned on an annuity purchased in Canada is 3% for the first $100,000 deposit and 1% on every additional dollar. Unlike mutual funds or other money managed products, annuities don’t sport an ongoing management fee to the adviser or broker. In fairness to Canadian advisers, however, it’s possible some Americans have been sold annuities precisely because of these rich compensation levels.

Despite their many benefits, annuities do have some drawbacks that consumers should weigh before purchase. Annuities are irrevocable, so they are very inflexible once established. Compared with other investments, the disadvantage of life annuities is that they leave no estate benefit regardless of the date of death (aside from any balance of payments for a guarantee period, if applicable). Clients must also be satisfied with the creditworthiness of the insurance company issuing the annuity.

Keeping these caveats in mind, Canada’s low adoption rate of annuities still suggests missed opportunities for our graying population to achieve financial security and peace of mind.

Prescribed annuities
One of the main categories of annuities in Canada is the prescribed annuity. These are contracts issued by an insurance company that are not backed by direct investments in equities (i.e., no mutual funds or pools, such as those used in segregated funds or universal life products). Instead, prescribed annuities are backed by the assets and future earnings of the issuing insurance company.

There are various types of prescribed annuities on the market today (see “Five main types of prescribed annuities,” left). Whatever the type, to qualify as a prescribed annuity, contracts must meet the following criteria:

- nonregistered funds must be used to purchase these annuities;
- the guaranteed income payment can only be issued up to the annuitant’s 91st birthday;
- the payments cannot be indexed, only allowing for a level flow of annual income; and
- income must start immediately after purchase of the annuity.

Unlike GICs or other fixed-income products, prescribed annuities are not subject to the interest accrual rule, where interest earned on a yearly basis is taxed even if not paid out. The

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**Five main types of prescribed annuities**

1. **Single life**: provides an income as long as the annuitant is living. An annuitant would purchase this type of annuity if the income is needed for just one person.
2. **Joint and survivor life**: provides an income for the lifetime of two individuals — a primary annuitant and a secondary annuitant (usually a spouse). Upon the death of one annuitant, the surviving annuitant can continue to receive an income. These types of annuities are best for couples who require an income stream after one of the parties insured by the annuity dies.
3. **Term certain**: provides guaranteed income for a specified period of time. These types of annuities are best for individuals who want a guaranteed income for the duration of time set out in the annuity contract, regardless of when they die.
4. **Immediate**: provides payments immediately after a single premium is paid into it. To maintain their tax effectiveness, all prescribed annuities are also immediate annuities.
5. **Straight life**: provides income to annuitants as long as they live; payments cease when they die. These annuities are usually used by individuals seeking the highest income stream and who are not concerned about their heirs receiving monies from the annuity upon their death. Straight life annuities are also used in advanced income and estate planning solutions.
Income Tax Act reserves a special taxation methodology for prescribed annuities where the total interest earned is spread out over all payments made during the annuitants’ lifetime. As a result, taxable income is lowered significantly because most of the prescribed annuity payment is deemed a nontaxable return of capital. This provides an elegant way for owners of prescribed annuities to minimize their tax burden relative to their cash flow.

Other tax benefits of prescribed annuities include:
- **Income splitting.** The Income Tax Act allows for qualified annuity income to be split between clients and their spouses.
- **Pension tax credit.** Depending on the client’s other pension or registered retirement income sources, a prescribed annuity may meet the qualification for the pension tax credit. This means clients and their spouses can each earn the first $2,000 of income tax free.
- **Old Age Security clawback.** The OAS clawback may be eliminated or reduced compared with an interest-bearing bond or GIC, as a large portion of the prescribed annuity cash payment is deemed a return of capital.
- **Probate taxes.** If there is a named beneficiary on a term-certain and last-to-die annuity that allows the annuity to bypass the estate, probate taxes will not apply.

Let’s examine a case study to see the benefits of prescribed annuities in real numbers. Imagine that you have a 70-year-old client, Ms. Smith, who has an investment portfolio of more than $3 million with a marginal tax rate of 46%. Although frustrated with current low interest rates, Ms. Smith contemplates buying $1 million worth of five-year GICs paying 3% annually. The resulting annual income of $30,000 is subject to $13,800 in taxes, leaving her with $16,200 annually in after-tax dollars.

On the other hand, if Ms. Smith purchased a $1 million prescribed annuity, it would pay her about $86,450 a year for the rest of her life. Given the special income treatment within the Tax Act, only $22,450 is taxable each year, leaving her with $76,123 a year after taxes. That’s an additional $59,923 in her pocket. On the down side, the annuity payments are fixed and the size of the estate is reduced.

A superior solution may be an insured annuity. Properly structured, an insured annuity can increase guaranteed cash flow, reduce taxable income on nonregistered monies, preserve the expected estate value and bypass probate taxes.

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Annui ties use mortality rates found in the general population, while life insurance mortality rates are based on people who pass the required physical and financial examinations. As long as a client is insurable, he or she can benefit from this pricing arbitrage.

A combination of two financial instruments that create powerful results on a guaranteed basis.

• Part A is the purchase of a prescribed annuity.
• Part B involves the purchase of a life insurance contract equal to the amount invested into the annuity. This guarantees the original capital will be paid back tax free to the designated beneficiaries upon the death of the annuitant.

This solution is the most attractive option for older clients who are relatively conservative on the investment front. Back-to-back annuities will achieve a higher after-tax cash flow during the clients’ lifetime and will return all capital to either their estate or beneficiaries upon their death. Depending on a person’s age and health, this solution can result in a material increase in after-tax returns compared with a GIC.

Continuing with our previous case of Ms. Smith, let’s assume that she wishes to leave the $1 million she used to fund the annuity to her heirs when she dies. She can easily accomplish this by using a portion of the $76,123 annual after-tax income she receives from her annuity to purchase a term to 100 life insurance policy with a face value of $1 million. (Term 100 is a life insurance policy with level premiums until age 100; if the insured lives past 100 he or she is still covered but no longer pays any premiums.)

Given her good health, the fixed premium for her acquiring the policy is about $32,400 a year. Starting with the $76,123 annually she has been receiving after taxes, she is left with $43,723 a year after paying her fixed insurance premium. This is still $27,523 — or 170% — more than the $16,200 she would have earned after taxes if she had pursued the GIC option. In her case, the numbers speak for themselves.

The reason that the back-to-back annuity works so eloquently — and with such stellar returns — is the differing actuarial mortality tables used by each of these distinct financial instruments. Mortality tables are effectively estimates of life expectancy for individuals depending on their age and gender. Insurers use these tables to calculate premiums on their various products.

Annuities use mortality rates found in the general population. Life insurance premiums, however, are based on the mortality rates of people who have been found healthy enough to pass the required physical and financial examinations. This means that the life expectancy of an annuity owner is much lower than a life insurance policyholder of the same age. As long as a client is insurable, he or she can benefit from this pricing arbitrage.

Another positive result of the back-to-back annuity is that the full investment is segregated from the rest of the client’s estate. This means the death benefit passes to the client’s beneficiaries tax free, while avoiding all probate fees. The life insurance is creditor-protected provided the proper beneficiary designation has been made.

Corporate capital gain solution
Business owners whose estate will have to pay large capital gains when they die should investigate the use of insured annuities to reduce tax and offset capital gains on death. One of the nice results of this corporate capital gain solution is that the client is

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Cash neutral during the entire process. Here is an overview of how it works.

**Step 1.** The corporation purchases an insurance policy on the key shareholder's life.

**Step 2.** The corporation purchases an immediate annuity on the key shareholder's life. This is generally accomplished with the payment of a lump sum to the life insurance company. In order to maximize income, the annuity will generally be paid for the life of the annuitant with no guarantee period.

**Step 3.** The corporation borrows funds to replace the capital that, where desired, can be used to re-acquire any liquidated assets.

**Step 4.** While the shareholder is alive, the corporation will receive payments under the annuity contract. Interest paid on the borrowed funds is tax deductible. In addition, because the insurance policy acquired by the corporation is required as collateral for the loan, the lesser of the policy premium and the policy's net cost of pure insurance will be deductible from the corporation's income. The net effect on an after-tax basis is that the annuity payments are sufficient to pay the insurance premium and the interest on the loan.

**Step 5.** Immediately before death, the shareholder is deemed to have disposed of his or her shares of the corporation for their fair market value. The amount of the loan reduces the value of the corporation's shares. The value of the annuity and the insurance policy without any cash surrender value, however, is nil. Therefore, there would be a reduction in the value of the corporation for income tax purposes.

**Step 6.** The amount of any insurance proceeds paid to the corporation, net of the adjusted cost basis of the insurance policy, would be credited to the corporation's capital dividend account. This would allow the payment of capital dividends to the estate of the deceased shareholder, i.e., a tax-free distribution that would be unavailable without the life insurance component of this solution.

This process results in tax savings to the deceased's estate and can create a positive cash flow for the client during his or her lifetime even if the loan interest rate increases to 9%.

For example, assume the sale of a company would result in a capital gain of $1 million upon the death of the key shareholder. The company purchases a term to 100 insurance policy for $1 million and a straight life annuity for $1 million in the name of the key shareholder. It also obtains a loan for $1 million. Assume that the after-tax cash received from the annuity is sufficient to pay the loan interest and insurance premiums. The day before the key shareholder's death, the life insurance policy and annuity have no value, but the loan of $1 million offsets the original value and resulting capital gain.

When implemented properly and for the right reasons, the corporate capital gain solution should be considered as a cornerstone of a balanced financial and estate plan for business owners.

**Deal with a competent professional**

To structure proper annuity solutions, your clients should consider their adviser's experience and professional qualifications—not all insurance agents are created equal. The world of annuities can become quite complex and, unlike a stock or term life insurance policy that can be sold or terminated quite simply if a mistake is made or personal circumstances change, an annuity is generally a lifetime decision. Accordingly, it should be assessed within the context of an overall plan by a credited (e.g., certified financial planner or trust and estate practitioner) and licensed life insurance professional.

While not for everybody, annuities are income solutions that are an essential part of a holistic financial, tax and estate plan. These solutions should be considered and investigated by clients and their trusted advisers if there is a need to increase their guaranteed cash flow, reduce taxable income and gains, and creditor-proof assets with the option of also preserving estate values.

Peter J. Merrick, BA, FMA, CFP, TEP, FCSI is president of MerrickWealth.com, an exit planning consulting firm in Toronto specializing in structuring insurance solutions that assist in business succession and estate planning.

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A steep price

With the OECD pressuring Canada to get tougher on improper payments, days of bribes to foreign public officials may be over.

On January 10, 2005, Hydro Kleen Systems Inc. pleaded guilty in the Court of Queen's Bench in Red Deer, Alta., to one count of bribery under Canada's Corruption of Foreign Public Officials Act (CFPOA). Hydro Kleen, an international company that removes coke and other byproducts from oil refinery pipes — a process known as pigging — admitted to having given $28,299.88 in a series of payments to Hector Ramirez Garcia, a senior immigration inspector with US Customs and Immigration Enforcement at the Calgary International Airport.

Garcia and his wife ran a consultancy called Genesis Solutions 2000 without the knowledge and approval of his employer. Between September 8, 2000, and November 30, 2001, Hydro Kleen retained Garcia to advise on the best ways for its employees to gain entry into the US on work visas. Industry leader Hydro Kleen, like its Canadian-based competitors, conducted a significant amount of business in the US. It contacted Garcia because of ongoing difficulties getting its Red Deer personnel permission to cross the border.

In return for the payments, Garcia advised Hydro Kleen's employees on what to say when questioned by customs officials and helped the company draft letters and documents required for entry into the US. Unbeknownst to Hydro Kleen, the court was told, Garcia also took it upon himself to discover the identity and impede the entry into the US of Hydro Kleen's competitors' personnel.

The bribery scam was unearthed following complaints from some competitors whose personnel were turned back at the Calgary airport. One company, Innovative Coke Expulsion Inc. (ICE), hired a private investigator after being told its people might not be allowed into the US for five years. The investigator, working on a tip, observed Garcia and his wife meeting at a Boston Pizza with Paulette...
Bakke, an assistant manager at Hydro Kleen, who slipped an envelope out of her purse and handed it to Garcia’s wife. In return, Garcia handed Bakke a large manila envelope.

Later, ICE obtained a civil search warrant for Hydro Kleen’s offices. According to a sworn affidavit, ICE discovered documents in the briefcase of Hydro Kleen president Robert Watts, including ICE financial statements, telephone and bank account statements, ICE’s US patent certificate and a photocopy of an ICE employee’s passport photo page. All the information had been contained in applications ICE had filed with US Customs and Immigration.

A subsequent RCMP investigation led to Garcia being charged with bribery under the Canadian Criminal Code and CFPOA. In July 2002 Garcia pled guilty and was sentenced to six months in prison and ordered deported upon his release. For its part, Hydro Kleen was fined $25,000.

The Hydro Kleen case was the first, and so far only, successful prosecution under the CFPOA. Enacted in 1999, CFPOA was created so that Canada would meet its obligations as a signatory to the Organization for Economic Co-operation and Development’s (OECD) anti-bribery convention. Under the act, it is illegal to pay off a foreign public official with bribes or kickbacks. While the Hydro Kleen case was not likely what the federal government had in mind when it developed the act, it was, nonetheless, a win in what has been a less-than-impressive track record by the Department of Justice.

In June, however, another case emerged when 63-year-old Nazir Karigar, a former official with Cryptometrics Canada Inc. in Ottawa, was charged under CFPOA with bribing an Indian government official “to facilitate the execution of a multimillion dollar contract for the supply of [an airport] security system,” according to an RCMP press release. Cryptometrics, a high-tech firm that provides face biometric authentication software among other services, was not charged.

If Karigar is convicted, he will be the first Canadian found guilty under the act. But he might soon be joined by others.

His arrest, and the investigation that preceded it, are a direct result of the OECD “holding our feet to the fire,” Cyndee Todgham Cherniak, an international business lawyer with Lang Michener LLP in Toronto, told The Globe and Mail. “We’ve got the OECD every few years asking us: How many prosecutions have you had? What are your [police officers] doing? Because you can’t say ‘Canada’s holier than thou — all we have are angels.’ People must be engaging in this behaviour. Why haven’t we found it?”

Sunny Pal, a former corporate governance counsellor in Lang Michener’s Ottawa office, notes that the World Bank has estimated “a trillion US dollars disappears unlawfully into secret pockets every year. That’s US$2.7 billion a day ... about double the value of all trade [exports and imports] between Canada and the US. Or, to make another comparison, it is more than five times Canada’s annual federal spending.”

If Canada does become more vigilant about enforcing CFPOA, Canadian firms must be aware of the potentially serious consequences they could face if caught in violation of it. Under CFPOA, companies found guilty can be fined an amount that is at the discretion of the judge. Individuals can be imprisoned up to five years if convicted of bribery and up to 10 years for possession or laundering of property and proceeds. Companies are liable for the actions of any agents they retain in a foreign jurisdiction and must be careful not to assume they can protect themselves by claiming they were unaware of what the agent might do to obtain business on their behalf.

At the moment they should likely pay much greater attention to similar legislation that governs other countries, especially the Foreign Corrupt Practices Act (FCPA), which has been in place in the US since December 1977. Failing to do so could make them susceptible to charges under FCPA.

Canadian firms need to realize that FCPA applies to foreign companies with securities registered in the US or that make illegal payments directly or via an agent through a US institution. Therefore, if a Canadian company makes an improper payment through a US bank account or a company employee who is a US citizen pays a bribe, the company has violated FCPA.

The consequences of violating FCPA can be severe. Civil and criminal charges could be laid. Guilty verdicts could bring multi-

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Inc., a former subsidiary of Halliburton, made improper payments to government officials in Nigeria via agents and subcontractors in regards to the construction of a natural gas liquefaction project. KBR pled guilty to criminally conspiring to violate FCPA, and Halliburton (which negotiated a nonprosecution settlement) agreed to pay US$382 million of KBR’s US$402 million in criminal fines, with KBR picking up the remaining US$20 million.

Not to be outdone by the colonies, last March the UK’s Serious Fraud Office arrested three directors of France’s Alstom, a world leader in transport and energy infrastructure, regarding “the suspected payment of bribes by companies within the Alstom group in the UK,” the office said.

Interestingly, a few weeks later, on April 8 the UK introduced its Bribery Act to “enable courts and prosecutors to respond more effectively to bribery at home and abroad,” a piece of legislation that was also likely inspired by pressure from the OECD.

While it seems apparent that countries such as Canada and the UK are finally following the US’s lead and taking bribery more seriously, this comes at a time when companies that are affected by the legislation may not be ready. A survey of UK companies released by Grant Thornton LLP in June 2010 found that more than three-quarters of companies surveyed have not invested in anticorruption strategies to deal with the Bribery Act, leaving many UK companies at unnecessary risk of the act’s harsh penalties. In addition, results from a recent survey performed by a global business consulting firm discovered that only 50% of senior corporate executives are ‘highly confident’ that their business control systems are managing their organizations’ business risks effectively, “ says William Olsen, a principal of Grant Thornton LLP in the US and author of The Anti-Corruption Handbook: How to Protect Your Business in the Global Marketplace. The survey also showed that fewer than 10% rated their control systems “excellent” in providing early warning signs to catastrophic risk.

Although in a 2007 report the OECD says “many countries are taking action to build knowledge” of bribery and corruption issues, it concedes there is still a lack of public awareness of its anti-bribery convention. While most large companies know paying bribes is wrong (whether they ignore the consequences is another matter), not all smaller-sized companies are aware of the rules of the game. Transparency International, which monitors bribery around the world, says bribery is a more problematic issue for small and medium-sized enterprises, which carry out most of the world’s business today. It says they may feel powerless in the face of demands for bribes and are often unaware that bribery can be resisted or how to go about it.

Ignorance, however, is not a defence. Many consulting firms offer advice on how to prevent or mitigate exposure to bribery and corruption. There are numerous resources available to companies that explain the various legislations. Of particular note is the Layman’s Guide to the FCPA, available on the US Department of Justice’s website.

A vital component of any company’s approach to protecting itself is to implement a formal and effective compliance program. This usually requires the establishment of a compliance department or, at minimum, a qualified individual responsible for the program.

Education is a critical aspect of any program. Employees, agents, subcontractors and anyone conducting business abroad on behalf of a company must be made aware that the company does not engage in illegal payments. (Facilitation payments, known as “grease money,” are permitted to ensure a company can do business in a country where it is established practice to pay a small amount of money to a supplier, for example, to install a telephone system.) A clear code of ethics is one of the most effective ways to communicate a company’s stance on bribery and kickbacks. It should have to be signed by each person working on behalf of the company every year.

If a compliance program is in place, it will likely mitigate a company’s exposure if a problem arises. However, the absence of such a program will reveal that acceptable due diligence practices were not in place. What happened to Siemens should serve as an incentive to maintain accurate accounting records and compliance practices.

The existence of a professional compliance program will also help reduce costs if, say, an RCMP investigation does occur. Such investigations can be disruptive and costly. The more prepared a company is for the worst-case scenario, the less damaging it will likely turn out to be.

Due diligence is also critical when selecting agents and subcontractors overseas. A company must conduct thorough background checks of anyone who represents it in business negotiations. That usually involves having a trusted employee and/or a consultant with experience in the country in question taking a hands-on role in vetting any prospective agents and other key workers.

It is impossible to eliminate all risk when doing business abroad. But the chances of getting caught up in a bribery or kickback investigation will be greatly reduced if compliance is taken seriously. Canada’s dismal track record of prosecutions under CFPOA might lull a company into thinking it can act with impunity abroad (although the tentacles of the FCPA are far reaching). But with the OECD pressuring Canada to get tougher on improper payments, those days may be at an end. Failure to realize that could result in some very painful consequences.

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Changing trilogy

New standards for reporting on controls at service organizations aim to meet demands of the current market environment

Service auditor engagements have become increasingly prevalent in the Canadian marketplace since the issuance of CICA Handbook — Assurance, Section 5900, "Opinions on Controls at a Service Organization," revision No. 52 (November 1986) that became effective for engagements covering periods on or after July 1, 1987. That standard changed little for almost two decades until a decision to make the reporting requirement similar to the then current US Statement on Auditing Standard No. 70, Service Organizations (SAS 70) standard was made. With this decision implemented, for periods commencing January 1, 2006, the Auditing and Assurance Standards Board (AASB) issued Section 5970, “Auditor’s Report on Controls at a Service Organization” that mirrored SAS 70 — it represented a significant revision to service auditor reporting in Canada.

Five years have passed, but companies and their auditors should not get too comfortable with the current standard. Management’s responsibilities in such engagements and how a service auditor performs and potentially reports the engagement will again change in Canada in the near future as a result of international efforts by the International Auditing and Assurance Standards Board (IAASB) and the American Institute of Certified Public Accountants (AICPA).

The IAASB was first off the mark. Although SAS 70 and CICA Section 5970 reports are issued outside their respective borders, the IAASB saw a need to develop an internationally recognized standard. The development of International Standard on Assurance Engagements 3402 (ISAE 3402), “Assurance Reports on Controls at a Service Organization,” approved in 2009, has now created a global standard for engagements to report on controls at a service organization. It has an effective date of June 15, 2011.

The AICPA, as part of its efforts to converge US standards with those of the IAASB, followed suit and began drafting a Statement on Standards for Attestation Engagements (SSAE) that would replace SAS 70 and more closely mirror ISAE 3402. SSAE 16 has recently been approved with the same effective date of June 15, 2011, although earlier implementation is certainly allowed. The revision of SAS 70 represents the first significant modification to the standard since it was issued nearly two decades ago.

With the morphing of SAS 70 to SSAE 16, the AASB began its project to finish the trilogy. With its strategy to closely follow the US requirements, it recently approved a proposed Canadian Standard on Assurance Engagements (CSAE) 3416, “Reporting on Controls at a Service Organization,” to replace the current Section 5970, effective December 15, 2011, with earlier implementation permitted.

The new standards are not aimed at overhauling how an engagement to audit and report on controls at a service organization is performed. Rather, they have been drafted
to modify the existing requirements to meet the demands of the current market environment and to fit into the modern framework for attestation.

While the standards do not differ significantly (nor from the existing Section 5970/SAS 70 requirements), they do present changes that may be challenging for service organizations that are not prepared when the new standards take effect.

Asserting publicly
The most significant change to the standards is the requirement that management of the service organization provide a written assertion attesting to the fair presentation and design of controls (type 1 report) or the fair presentation, design, and operating effectiveness of controls (type 2 report). The service auditor, however, will continue to directly report on whether controls are fairly presented and suitably designed or fairly presented, suitably designed and operating effectively. It is not intended that the auditor report on management’s assertion.

In order to provide a written assertion, those who sign the assertion will need a reasonable basis for making it, which may include developing their own processes to support the assertion if such processes are not already in place. The standards provide specific requirements that management must meet, including:

- selecting suitable criteria, which will be used to prepare its description of the system as well as to evaluate whether controls were suitably designed (point in time or type 1 report) or suitably designed and operating effectively (period of time or type 2 report); and
- identifying the risks that threaten the achievement of the control objectives stated in the description.

When these standards become effective, unless management agrees to provide an assertion, the service auditor will not be able to accept or will need to withdraw from an engagement to report on controls at the service organization. If a law or regulation prevents a service auditor from withdrawing from the engagement, the Canadian service auditor will need to disclaim the audit opinion.

To add to the complexity, if the service organization relies on controls at a subservice organization and management elects to use the inclusive method of reporting, management will also need to determine whether controls at the subservice organization are suitably designed or suitably designed and operating effectively. This requires a written assertion by the subservice organization and will also require that the subservice organization provide a letter of representation at the end of the audit.

Providing a public assertion will certainly impact the organization. CSAE 3416 provides examples for assertion content. The assertion is more comprehensive than that provided in the past in letters of representation that auditors required. The new letter of representation starts with a reaffirmation of the assertion.

Service organizations will need to have processes in place so management can assert that controls are suitably designed and operating effectively. In addition, the service organization will need to determine who is responsible for making the assertion and for overseeing the supporting processes.

These new requirements should not be onerous for service organizations that currently have control monitoring processes in place and plan for the change. The change will be problematic for those service organizations that procrastinate.

What else is new?
The requirement that management provide an assertion is the most significant change in the new standards. However, there are other matters that should be highlighted.

In the old Section 5970, there was no guidance provided to the service auditor in assessing whether management has used suitable criteria in preparing the system description, in evaluating whether the controls were suitably designed and in evaluating in a type 2 report whether they operated effectively throughout the period. This is now provided in CSAE 3416.

In a type 2 report, if the work of the client’s internal audit function has been used, the service auditor, in his or her report, is required to include in its description of tests the internal auditor’s work, acknowledgement that it was performed by internal audit and the service auditor’s procedures with respect to that work.

The requirement that management provide an assertion is the most significant change in the new standards.

But there are other matters that should be highlighted

In a type 2 report, the service auditor’s opinion on the fairness of the presentation of the description of the service organization’s system and on the suitability of the design of the controls is for the examination period rather than as at a specified date.

When obtaining an understanding of the service organization’s system, the service auditor is required to obtain information to identify risks that the description of the service organization’s system is not fairly presented or that the control objectives stated in the description were not achieved due to intentional acts by service organization personnel.

When assessing the operating effectiveness of controls in a type 2 engagement, evidence obtained in prior engagements about the satisfactory operation of controls in prior periods does not provide a basis for a reduction in testing, even if supplemented with evidence obtained during the current period.

With regard to documentation, 60 days after the date of the service auditor’s report is viewed as an appropriate time limit in which to complete the assembly of the final engagement file.

Benefits for early adopters
The new standards that have been drafted by the IAASB and AICPA are effective for assurance reports covering periods ending on or after June 15, 2011 and, in the case of the new Canadian standard, periods ending on or after December 15, 2011. Service organizations and their service auditors will have the option of early adoption of the new standards. Although there may be initial challenges in meeting the new standards, service organiza-
tions may wish to have an engagement to report on their controls performed under the new standards before the required date.

Early adoption may confer certain benefits. For example, service organizations that early adopt the new standards may be perceived as having a stronger control environment relative to their competitors that do not early adopt or could be viewed as market leaders. Early adoption will also give service organizations and their service auditors a longer window to assess whether management has implemented the necessary processes to comply with the new standards and avoid time-pressured discussions.

Non-ICFR
This new standard is applicable to controls that are likely to be relevant to user entities’ internal control over financial reporting. It is not to be used for non-ICFR scenarios. Given the fact that service organizations often provide services that do not relate to ICFR, an alternative to CSAE 3416 is needed. Paragraph 2 of CSAE 3416 allows the standard’s guidance to be used in developing reports under Section 5025, “Standards for Assurance Engagements other than Audits of Financial Statements and Other Historical Financial Information.” The CICA is considering whether to issue nonauthoritative guidance similar to that being developed by AICPA that deals with using the SSAE 16 as guidance for non-ICFR reports.

Taking the initiative
Not every organization will choose to early adopt. Varying circumstances and objectives make the consideration unique for each organization.

The change in standards is going to happen and all service organizations will be impacted. The uncertainty is whether the impact will be a positive one or a negative one. Our view is that service organizations that act now to proactively understand the impact of the changes and to be ready for them will likely see a positive impact and enjoy a competitive advantage.

Whether or not an early-adoption approach is taken, we strongly recommend all service organizations begin planning for the change as early as possible to manage the changes to a positive implementation.

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Technical editor: Ron Salole, vice-president, Standards, CICA
A reversal on appeal

A higher court overturns a Quebec Superior Court ruling and renders accountants liable for damages

In a recent decision (Agri-Capital Drummond Inc. v. Mallette et al., 2009 QCCA 1589), the Quebec Court of Appeal overturned a Superior Court judgment rendered in 2007 that dismissed Agri-Capital Drummond’s action against the accounting firm of Mallette Maheu. The Court of Appeal found the accountants liable and rendered a decision departing from the existing case law relating to causation that led to an award of what might otherwise have been considered (noncompensable) indirect damages. The accounting firm filed a leave to appeal the decision to the Supreme Court of Canada, arguing the new approach adopted by the Court of Appeal in Mallette was a matter of public importance in Quebec, however the Supreme Court of Canada dismissed the application for leave to appeal on February 11, 2010.

Montreal-based Mallette Maheu was retained to prepare the financial statements and income tax returns for feed manufacturer Nutribec Ltd. for fiscal 1998 and 1999. Arthur Andersen (which had forged a relationship with Mallette Maheu in 1994) prepared the financial statements for fiscal 2000 and 2001 and Mallette Maheu prepared the financial statements for fiscal 2002 and 2003.

In 1998, Nutribec sold some of its assets, and as a result, several accounts receivable worth $4.5 million were written off as a recoverable debt and a loss was claimed. In 1999, the accountants took into consideration the sale that occurred in November 1998 and claimed the tax loss on the sale of the accounts receivable in the amount of $4.5 million, the same account receivable on which the loss had been claimed in the previous fiscal year.

On Dec. 18, 2001, Nutribec’s two majority shareholders — Agri-Capital Drummond and Groupe DLPC Inc. — signed a shareholder’s agreement following Agri-Capital’s acquisition of a number of Nutribec’s shares. On Sept. 6, 2002, DLPC exercised its rights under the shotgun clause contained in the shareholder’s agreement and offered to buy Agri-Capital’s shares. On Oct. 18, 2002, Agri-Capital turned down DLPC’s offer and consequently, as required under the shotgun agreement, bought DLPC’s shares on Nov. 18, 2002 for $4.3 million.

In deciding to buy DLPC’s shares, Agri-Capital...
that the value of Nutribec’s shares at the time excluded the tax trial at the Superior Court level. Justice Guertin determined that the value of Nutribec’s shares at the time excluded the tax losses. Consequently, the court came to the conclusion that Agri-Capital had not suffered a loss since it had not been deprived of a gain having acquired shares worth the value. Justice Guertin also found that the company could not complain about the loss since it simply did not exist. Justice Guertin therefore dismissed Agri-Capital’s action with costs including the accountants’ experts' fees and costs.

Agri-Capital subsequently appealed the Superior Court decision and the Court of Appeal overturned the Superior Court’s decision. It is interesting to note that the Court of Appeal agreed with Justice Guertin’s analysis when he determined that the plaintiff had not suffered a loss since it had not been deprived of a gain having acquired shares worth the value. However, the Court of Appeal took the view that Justice Guertin erred when he concluded that the company could not claim such damages since the losses had never really existed.

The Court of Appeal approached this issue by asking if the losses had existed, as was represented by the accountants, what benefit the company could have obtained. In its reasons, the Court of Appeal refers to the theory of loss of chance — although its analysis on this point is rather nebulous. The appeal court found that based on a balance of probability, had the tax loss existed, Nutribec would have obtained an advantage of $313,000. Since the plaintiff was now the sole shareholder of Nutribec, it followed that all advantages that could have benefited Nutribec would benefit its shareholder through either additional dividends or from a return in capital following the liquidation of Nutribec. The court therefore concluded that an amount of $313,000 should be granted as damages to the plaintiff company, Agri-Capital.

The civil law approach to professional liability is different from the common law approach, namely that a fault-damages causation approach is applied rather than the two-part duty of care analysis. Court of Appeal appears to have been influenced by equitable concerns in this case, expanding on the traditional understanding of causation in order to reach what it likely considered an equitable result.

This departure from existing case law, which effectively creates an action for shareholders on the basis of nonexistent value erroneously represented in financial statements, is of importance given the new approach to causation that it represents as well as its potential to expose accountants to indeterminate liability. As mentioned above, the Court of Appeal refers to the theory of loss of chance. The Quebec courts have, in exceptional cases, accepted claims on the basis of a loss of chance argument. However, in such cases, the analysis remains focused on what would have been the situation before the professional's error. For example, in a case where a lawyer neglects a file and allows the limitation period to expire, the court would look at the client's chance of having a successful lawsuit had it not been for the lawyer's error. In this case, there was no real loss of chance, given that even if there had been no error, the losses would still not have existed.

(For information on the first level judgement rendered by the Superior Court in the case, please see “Accounting malpractice,” by Marie-Isabelle Dionne, Camagazine, October 2007, or go to the archives at camagazine.com.)

Jo-Anne Demers, LLB, is a partner and chair at Nicholl Paskell-Mede in Montreal. She is also the Technical editor for Legal issues.

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A disturbing dismissal

Stephen Harper is the first economist to be elected prime minister in this country. You would think his government would promote economic policies generally embraced by economists. But that hasn’t been the case. In many major policy issues, his government’s positions run counter to the prevailing opinion of economic experts. Here are two examples.

In 2006, one of the Tory government’s first budget-related decisions was to reduce the goods and services tax by one percentage point. Introduced by the Mulroney government in 1991, the GST replaced the 13.5% excise tax on products manufactured in Canada. Despite their initial opposition, the Liberals retained the tax when they took power in 1993. Economists are strong supporters of the GST, holding it as the ideal tax. It applies only to consumption and doesn’t penalize savings. When combined with a tax credit for low-income Canadians and the food products exemption, it is a fair tax, creating far less disparity than income tax, while being easier and less costly to administer. Today the GST contributes close to $35 billion a year to federal coffers.

We would normally expect a Conservative government to raise the GST and reduce personal income tax. Harper chose the opposite, with a second GST cut of 1% in 2007. Both decisions were purely political, to project an image of the Tories as a low-tax government, an image reinforced by the GST’s high profile. However, in public policy terms, few economists could make sense of this inept decision.

Statistics Canada is mandated to provide a portrait of Canada to help governments and the private sector make better decisions. With a $500-million annual budget and a staff of 5,000, StatsCan works in relative obscurity, yet has a solid reputation worldwide. Its data, available on the Internet, are primary working tools for economists.

However, the Harper government has had it in for StatsCan since it was first elected. It started early in the first mandate with significant budget cuts. Then it was the cancelling of several surveys. The recent controversy about the long-form census is the final step in a series of confrontations. That the government would actually impair the quality of census information is a hard blow for economists, as so many public-policy and private-investment decisions are based on StatsCan data. Of course our economy will survive the diminished integrity of the census data. But why did the Tories target the census?

The official reason that the long form is an intrusion into our privacy doesn’t hold water. Every day, Canadians are humiliated at airports by embarrassing searches that are totally useless for statistical purposes. Canadians entering the country must answer personal questions by Citizenship and Immigration Canada agents. How come their European counterparts simply examine their citizens’ passports, with no questions asked? Is our government really concerned with protecting our privacy?

StatsCan is probably being hounded for a different reason. In Canada, as elsewhere, the census reflects the government’s presence in our daily lives. (In the US, the first article of its constitution requires a census be carried out every 10 years.) The census is an easy target to demonstrate “small government” principles.

The Harper government’s decision was simply another electoral tactic, allowing the Tories to present themselves as small-government champions, who prevent StatsCan from sticking its nose in our business. Whether the decision is good for public policy doesn’t matter. It’s often said that when one economist says white, another says black. However, on the GST and census issues, economists were virtually unanimous in questioning the appropriateness of the new policies. That a government led by an economist would completely dismiss these concerns is definitely disturbing to his peers.

Marcel Côté is founding partner at SECOR Consulting in Montreal
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