A little financial knowledge is a dangerous thing. Can CAs help?

The good, the bad, the ugly P. 26

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Canadian youth lack money skills P. 5
Your appliances are getting smarter P. 8
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Get money-smart

Many Canadians are not saving enough and some save nothing at all. This could lead to a sad state of affairs for our economy.

The lack of financial literacy among segments of the populace can affect an economy adversely. The subprime mortgage crisis in the US is one good example. There is evidence that many borrowers did not know what a “subprime” mortgage entails. If financial literacy is “having the knowledge, skills and confidence to make responsible financial decisions,” then it needs to be taken seriously by Canadians, of whom 42% lack basic financial literacy.

In “It pays to know” (p. 18), Robin Taub and Mary Teresa Bitti tell us why it is important to be literate in financial matters. Taub, a CA specializing in financial literacy and author of A Parent’s Guide to Raising Money-Smart Kids, and Bitti, a freelance writer, write: “The CICA’s own research shows that half of Canadian adults are not saving enough, setting aside less than 10% of their monthly income, with 25% saving less than 5% or nothing at all.” These are scary figures. One typical scenario financial advisers see is the 50-something baby-boomer couple who had not done any financial planning beyond the last-minute RRSP contributions and woke up one morning to a six-figure mortgage and tuition for children in university. Don’t fail to read this fascinating investigation of current efforts to improve financial literacy in Canada.

There are clients, and then there are clients. Some, everyone wants; others, you wish you could leave in the nearest dump. What do you do when you have the latter client? John Lorinc writes about both in “The good, the bad and the ugly” (p. 26). Read how to cut the bad and cultivate the good in this piece.

In this issue, columnist Jim Carroll tells us we may soon have appliances that will make perfect microwave popcorn — the kind that doesn’t leave any hard kernels (p. 8). Marcel Côté warns us about economists still preaching the values of Homo economicus, who allegedly only thinks about market outcomes. Today, he says, people also think about happiness and social concerns (p. 48).

I’d like to say thank you and goodbye to Christine Wiedman, associate professor and codirector of the University of Waterloo’s school of accounting and finance PhD program, who has been our education technical editor since 2008. I would like to welcome Karim Jamal, chair of accounting, operations and information systems in the school of business at the University of Alberta and CAmagazine contributor, who is taking over this role.

We also have regulars on standards (p. 32), assurance (p. 36) and education (p. 40).
It pays to know

The average Canadian family carries a debt load of $100,000 and many Canadians are not saving enough. With great implications for our economy, financial literacy is a hot topic today and CAs can play a role in ensuring Canadians improve their money-management skills

BY ROBIN TAUB + MARY TERESA BITTI

The good, the bad and the ugly

Good client relationships don’t happen by chance, and a good practice doesn’t come about by accident. They are the result of a strategic approach, screening potential clients, getting rid of difficult ones and servicing the dream clients well beyond their expectations

BY JOHN LORINC
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Breaking news, tax updates, job postings, archives, more articles: you'll find them all at www.CA magazine.com
When you’ve already swum the English Channel, climbing the highest peak in the world seems like a suitable encore. And for CA Bill Borger, reaching the south summit of Mount Everest in May makes him the first Canadian to accomplish both these feats.

The 36-year-old Alberta native conquered the channel in 2000, braving illness and jellyfish stings (see “Bill’s excellent adventure,” January/February 2001). Everest wasn’t any easier — altitude changes caused him to throw up so violently he stopped eating and lost 33 pounds in six weeks. He also witnessed a Japanese climber die en route. “When we were going to the summit I told myself that this would be the worst day of my life, ‘bring it on,’ and that prepared me for the bad stuff,” he says. “What made me persevere is the notion that pain is temporary but regret is forever.”

Borger’s efforts on Everest raised more than $440,000 for the Calgary HandiBus Association, a nonprofit organization he appreciates because his grandmother used the service. “The money will buy new buses and I also liked the connection with my climb and getting people with mobility issues around the city.” He will also offer speaking engagements for any donors who contributed $25,000 or more.

Now back home, Borger spends time with his two children and focuses on being a president of the family construction business. “The climb definitely cost me in profitability and relationships, but you have to be ready for these consequences,” he says.

And while he is eager to give his body a much-needed break, Borger won’t be giving up his adventure quests anytime soon. “I think I’ll try running next — maybe an ultramarathon through the Sahara.”

Rosalind Stefanac

**Gen Y has a bum rap, says report**

The stereotype that millennials in the workforce are hard to please and difficult to manage doesn’t reflect reality, recent research finds. According to a white paper titled “Attitude? What attitude?” by the Kenexa High Performance Institute, a division of global HR firm Kenexa, 60% of millennials — those born between 1982 and 2003 — are extremely satisfied with their employers and 63% say they have opportunities for growth and development at their companies.

In contrast, 54% of older workers cite overall satisfaction and just half report growth opportunities. The 2011 study surveyed more than 30,000 working-age people in 28 countries, including Canada, the US and UK.

“Our research indicates millennials often stand on common ground with their older counterparts,” says KHPI research manager Rena Rasch. “The millennials may even turn out to be better employees and — eventually — better employers than their predecessors.”

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**Résumé**

1999 obtains CA designation (Alta.)
2000 swims English Channel
2002 joins The Borger Group of Cos.
2010 becomes president of the Underground and Earthworks divisions
2011 climbs Mount Everest

**PHOTO:** COURTESY BILL BORGER

Bill Borger, seen here at the Matterhorn, spent two years climbing 40 peaks before conquering Mount Everest in May

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**UPFRONT**

*News, people, briefs, trends + tips*
YOUTH LACK MONEY SKILLS

Nearly all (94%) Canadian youth aged 16 to 22 say being good with money is an important life skill, but only 41% are very confident they have the knowledge, skills and discipline to manage their money well, according to the CICA’s Youth Financial Literacy Survey conducted by Harris/Decima. Less than half of respondents are very confident they could stick to a budget (33%), develop a budget (36%), limit spending (39%), avoid financial fraud (42%) or use credit cards responsibly (48%).

Given this lack of confidence, many young people are either avoiding financial activities or doing them poorly. For example, only 43% are budgeting and, of those, 36% say they are very successful at it. Although most (73%) are trying to limit spending, only 33% say they do so very successfully.

Who should be teaching financial literacy to kids? Parents, according to the youth polled. Nine in 10 (89%) say parents have a lot of responsibility for educating them about money, compared with schools/teachers (24%), financial services sector/banks (16%) and government (13%). The survey also indicates just 16% of parents have been extremely successful in this area, showing there is an opportunity for parents to do more to help their children develop money management skills.

Note: among its financial literacy initiatives, the CICA is developing a guide to help parents teach children about money (see “It pays to know,” p. 18).

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

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<th>% of youth very confident they have the knowledge, skills and discipline to:</th>
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<td>54%</td>
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<td>Save money for a major purchase</td>
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Source: CICA’s Youth Financial Literacy Survey, 2011

ASK AN EXPERT

I KEEP BUTTING HEADS WITH MY BOSS. WHAT SHOULD I DO?

Friction between supervisors and employees can stem from differing work styles. It’s not possible to control your boss’s actions, but you can change how you respond to them.

Here are five types of challenging bosses and tips for working with them:

The micromanager. Trust is usually the issue here, so make sure you build it. Don’t miss deadlines, pay attention to details and keep your supervisor apprised of all the steps you’ve taken to ensure quality work.

The poor communicator. At the outset of a project, ask for any information your boss has not yet provided. Diplomatically point out that these details are necessary to ensure you meet his or her expectations. Seek clarification when confused and arrange regular check-ins.

The mixed bag. This manager’s moods are unpredictable — he or she may confide in you one day and turn a cold shoulder the next. Try not to take this disposition personally. Stay calm and composed. When this boss is on edge, try to limit communication to urgent matters.

The bully. Stand up for yourself. The next time your boss shoots down your proposal, for example, calmly explain your rationale. Often, he or she will relent when presented with a voice of reason.

The saboteur. Ensure your contributions are more visible to others, especially senior management. Get information in writing from your boss so you have a chain of communications to refer to, if needed.

Robert Hosking is executive director of staffing service OfficeTeam (www.officeteam.com).
1 Rank of departing and arriving on time as most important elements of customer satisfaction among frequent flyers in a 1998 survey. Having a frequent-flyer program ranked last.

1.3 Millions of reward flights issued by Aeroplan in 2010. Since launching in July 1984, more than 600 billion miles have been redeemed by travelers.

13 Average possible percentage savings on travel expenses available to large Canadian companies participating in frequent-flyer programs, according to a 1989 study. The authors also found only 30% of award miles were used.

50 Percentage of Canadian business travelers surveyed in 2010 who said their company had no official policy regarding travel.

For those with a policy, fewer than one in five said they obeyed it “to the letter.”

82.1 Percentage chance a requested booking on a set date will be available on Air Canada using reward miles, according to a survey done in March and April of 24 airlines. Air Canada ranked seventh, Brazil’s GOL placed first (100%) and US Airways last (25.7%).

$1,045 Cost in US dollars of a two-and-a-half-day MySky seminar in Detroit to overcome one’s fear of flying. Experts suggest at least one in three flyers experience anxiety and one-quarter of those are frequent flyers.

1979 Year Texas International Airlines launched the world’s first frequent-flyer loyalty program.

Fly with me In July, a Chicago consultant recorded his 10 millionth mile flying with United Airlines. Thank you for choosing the world of frequent flyers.

Going Concern

PHILIP MAGUIRE, CA MANAGING DIRECTOR, EXECUTIVE MENTORS

COMPANY PROFILE: Set up in 2010, the Toronto-based firm provides corporate clients with mentoring services to help executives manage their career paths. It also advises entrepreneurs and small-business owners on how to get the company to the next level or deal with more immediate concerns such as mergers and acquisitions. The firm, which was profitable in its first year, currently has a roster of 19 mentors who are retired or semi-retired senior executives, most of whom were presidents, CEOs or business owners.

HOT FACTOR: Outside mentors’ advice is often more objective and helps avoid conflicts that are created when in-house executives are involved. “Our services offer a second business perspective that enables employees to manage their careers better and engage more closely with the company,” says managing director Philip Maguire.

COOL PROJECTS: Executive Mentors plans to add to its existing roster of mentors by aggressively expanding its presence beyond Central and Western Canada into Quebec. Maguire believes advice from the firm’s stable of business veterans would help entrepreneurs make more effective pitches to bankers and angel investors.

IN HIS OWN WORDS: “Coaching is a short-term exercise focused on addressing an employee’s specific skills deficiencies. It helps them overcome their weaknesses so they can pass their next job approval rating. In contrast, mentoring takes a long-term approach that passes on to individuals soft skills such as emotional intelligence and teaches them how to navigate the corporate political landscape.” Ken Mark
Savings, not age, now dictates “right” time to retire

Three out of four (73%) middle-income baby boomers in the US say their financial situation, not age, is now the key trigger for when to retire, according to a study by Bankers Life and Casualty Co.’s Center for a Secure Retirement, the research arm of the Chicago-based insurer.

The study, which focused on 500 Americans aged 47 to 65 with incomes between US$25,000 and US$75,000, found that one-third expect to retire after age 65 and 31% are unsure at what age they will be able to retire. A majority said they had not saved as much for retirement as they had expected to at this point in their lives (see chart below), and two in three (67%) thought they would be in a better financial position for retirement than they are now.

“On the new road to retirement, the majority of Americans can now retire only when they feel they can afford to do so,” said Scott Perry, president of Bankers Life and Casualty.

Career-limiting moves

You may not think anyone notices or cares when you have raw onions at lunch, but bad breath can seriously decrease your chances of being promoted, finds a survey by US recruiter CareerBuilder.

Nearly 3,000 hiring managers were asked to name the personal attributes that would make an employee less appealing for a promotion. Here are their top responses:

- Piercings - 37%
- Bad breath - 34%
- Visible tattoo - 31%
- Wrinkled clothes - 31%
- Messy hair - 29%
- Dresses too casually - 28%
- Too much perfume or cologne - 26%
- Too much makeup - 22%
- Messy office or cubicle - 19%
- Chewed fingernails - 10%
- Too suntanned - 4%

WEEKEND INTERRUPTED

More than 60% of North American employees get email from their bosses on weekends — and are expected to reply, according to a survey by human resources firm Right Management. A third of respondents say this happens often, while 30% say the imposition is only occasional.

NOT JUST A QUICK BUCK

Contrary to popular belief, most online investors aren’t looking for speedy financial gains, an RBC poll finds. Just 9% of Canadian online investors seek short-term profit, while 85% use online investing accounts for either long-term or a combination of both long- and short-term goals.

SWEET ON SMEs

Canadians “heart” small-business owners. More than 90% of Canucks admire entrepreneurs and would approve of their child or immediate family member starting their own business, according to a survey conducted for the Canadian Federation of Independent Business.
Your appliances are getting smarter

Perfect microwave popcorn. I thought by now we’d have mastered this but, for all its successes, the high-tech industry still has not figured out how to make perfect microwave popcorn.

The problem with making popcorn in a microwave is that every oven has a different power output, so all you can do is listen carefully to the popping pattern to figure out when it might be finished. There has to be a better way.

Back in the early 1990s, as the concept of Internet-based home automation started to appear, I figured there would one day be a perfect microwave popcorn machine. While on stage talking about the future, I would tell the story of perfect microwave popcorn — predicting that I’d have a device in my home that would read the bar code on the popcorn bag, query a database through the Internet, and figure out the exact timing for that particular microwave device.

Orville Redenbacher would partner with appliance manufacturers and come up with a really cool automated system that would provide perfect popcorn every time. Internet-linked appliances, back-end databases and a marriage of consumer food products to the Internet and technology. It seemed like a pretty simple idea.

Well, as far as I know, it hasn’t happened — yet.

But this year at the Consumer Electronics Show in Las Vegas, there were glimmers of hope. Clearly, there were two big trends on display — tech/connectivity in the car, and tech/connectivity in the home.

A lot of the news sizzle surrounds tech in the car; the tech-in-the-home field isn’t getting as much attention, because it’s just not as exciting as wheels. But there are glimpses of what is going on: Whirlpool has announced that in 2011, it will have produced one million smart-grid-compatible clothes dryers that utilize smart connectivity to become more efficient. And imagine having a dishwasher or clothes dryer that sends you a text message when the cycle is finished — that’s going to be a regular part of our lives soon, too.

Massive pervasive interactivity on a grand and unimaginable scope will soon be upon us — and the younger generation, weaned on a diet of connectivity, will begin reshaping their world in fascinating ways. Already my 16-year-old son reminds me to stop one car length behind the normal spot at a red light — because he knows I’ll be on a pressure pad that will force an automatic green turn light.

What happens to our world when everything around us plugs in? Fascinating things, including perfect microwave popcorn. Buy the intelligent microwave, bring it home, and plug it into the wall. The microwave will use the basic Internet connectivity found in your home to establish a connection.

The package of microwave popcorn you purchased includes a bar code that uniquely identifies it. When you press “cook,” the microwave will read the bar code. It will then use the Internet connectivity to send a query to a central database. There, it will ask, in effect: "For this particular model of microwave and for this particular package of popcorn, how long is the cooking time?” Receiving the answer, it will proceed to provide you with perfect popcorn — every time.

Farfetched? I don’t think so. I believe we are destined for a future in which everyday appliances and technologies will be linked to the Internet; often through the home network or a wireless Internet connection that is set to invade your home. As this occurs, devices will emerge with capabilities that are quite unimaginable today.

Jim Carroll, FCA, is a well-known speaker, author and columnist. Reach him at jcarroll@jimcarroll.com or log on to his website at www.jimcarroll.com
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Benchmarking survey 2011

In December 2010, we launched our first-ever business process benchmarking survey (see www.camagazine.com/benchmarkingsurvey10). The idea was to give organizations a chance to compare their performance with that of other organizations to expose possible problems and targets for improvement. Given the lack of benchmarking data in Canada, we were sure we could all benefit.

Unfortunately, the survey did not draw enough respondents to provide statistical reliability. But we learned a lot in the process and have made improvements that we hope will encourage you to participate, if you have not already done so.

First, a few lessons we learned — or relearned.
1. There will always be people who try to beat the system. We had a number of respondents who entered bogus data just to see the results. We have fixed this problem by scanning for bogus data and eliminating the results they generate.
2. For any given metric, the results can change dramatically according to the size of the organization and other factors. For example, a large, complex organization might take months to complete the budgeting process, while a small company might take just days or weeks. That is why the benchmarking survey tool allows you to compare your organization’s metrics by industry, company size, complexity and region.
3. Accounting and ERP systems don’t contain some of the data that could be used in the benchmarks. In these cases, you have to decide whether it makes sense to look for the information, depending on the value of knowing the metric.
4. Before starting the survey, it helps to know what data you will need. The system will allow you to download the list of metrics in advance.

Now for the changes and improvements we have made since last December.
- **Simplifying.** The first version contained 63 metrics across 15 business processes — too daunting to handle for many organizations, even though you could skip over many of the metrics. We now offer a “light” version with 13 of the most important metrics. You can always switch to the advanced version later.
- **Expanding the respondent base.** The business process benchmark tool will be opened up to other organizations to increase the number of respondents.
- **Introducing new metrics.** We have added manufacturing to the business processes and have included metrics for efficiency (standard labour hours/actual labour hours x 100), timeliness (percentage of production completed on time), quality (percentage of products returned and scrap percentage) and cost (production downtime/total available production time x 100).

The results can change dramatically according to the size of the organization and other factors

- **Adding accounting/ERP systems to the mix.** In addition to comparing your organization by industry, company size, complexity and region, you can see how you compare with other organizations that have the same accounting/ERP system as yours.

Despite our best efforts, organizations might have their own reasons for choosing not to participate, with concerns about confidentiality being chief among them. We will release information only in the aggregate and not publish any individual responses. We have also steered clear of financial metrics for revenue and costs.

For an expanded version of this article, please visit www.camagazine.com/benchmarkingsurvey11. For the survey, visit www.180benchmarks.com. Please complete it by December 15. As always, suggestions for improvement are welcome.

Michael Burns, MBA, CA • IT, is president of 180 Systems (www.180systems.com), which provides independent consulting services, including business process review, system selection and business case development.

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Merger update: CA-CMA leadership ponders next steps

After a summer of extensive dialogue about the future of the Canadian accounting profession, the CA-CMA consultation process has drawn to a close. Now it is up to the leaders of the two bodies to review the feedback and determine whether to proceed further toward a merger.

Throughout the consultation period, CAs and CMAs have candidly shared their points of view, not only on the CPACanada website, but also at face-to-face meetings and town halls hosted by provincial CA and CMA organizations across Canada. The discussion revolved around members’ views about the guiding principles presented in the position paper as a basis for creating a new chartered professional accountant (CPA) designation.

More than 40,000 CAs, CMAs, candidates, students and other interested stakeholders have visited the consultation website, www.CPACanada.ca, to download the position paper, view the CEO videos and directly exchange views with the CEOs of the CA and CMA national organizations. To date, approximately 4,000 members, candidates and registered students have participated in the more than 60 town hall meetings hosted by provincial and regional CA and CMA organizations. In addition, surveys conducted throughout the consultation period sampled the views of members from both organizations as well as those of other key stakeholders.

While CAs largely endorsed the concept of a consistent code of conduct for Canadian accountants and the idea of a single high-quality qualification process, a number of them expressed concerns that a merger would dilute the value of their designation. Others felt the use of the CPA designation in Canada could cause confusion with the certified public accountant designation used in the US.

In his CEO Commentary on the CPACanada website, Kevin Dancey, CICA president and CEO, argues that doing nothing may prove to be an even bigger brand-dilution risk than merging, if Canada’s CAs ultimately find themselves lacking sufficient size to have relevance at the global table or discover that they are not aligned with the global designation of choice. With the concept under consideration, members will receive a new CPA and they will also retain their CAs and be able to use their existing designations forever. Being aligned with both the CA and CPA designations is a much safer and more sensible strategy in Dancey’s view.

He also cautions against just looking within the borders of Canada without recognizing what is happening to accounting globally. By way of example, Dancey points out that in Europe, the Association of Chartered Certified Accountants (ACCA) and Institute of Chartered Accountants in England and Wales are vying for control over the use of “chartered professional accountant.” He notes that the ACCA has already made several attempts to gain a foothold in Canada and currently has a mutual recognition agreement with CGA-Canada.

Surveys to gauge the attitudes of business leaders, governments, regulators and public-policy experts about the proposed merger were also conducted during the consultation period. The results indicate that concerns over brand dilution and confusion are not generally shared by leaders in Canadian business and government. Most Canadian business leaders said that not only would a merger be positive for Canadian business, a combined qualification process and designation would also result in better-quality professionals. Few had any concerns with the move to the CPA designation; most noted it would reduce confusion and make hiring easier.

The majority of government and other stakeholder groups surveyed also identified benefits arising from the merger. There was unanimous agreement that a consistent code of conduct would be beneficial for Canadian business. Most said a merger would be positive for their organization and for Canadian business as a whole. While the majority agreed a merger would strengthen Canada’s voice at the global standard-setting table, few believed the new Canadian CPA designation would create confusion with the US CPA designation.

A full report on the consultation will be made available to all members shortly. Meanwhile, the national and provincial boards and councils of both bodies are analyzing all the input received with a view to determining whether or not to proceed toward a concrete proposal for a merger. Should they agree to proceed to the next step, the CA and CMA national and provincial boards and councils will prepare a concrete proposal for member consideration and support.

Watch for further updates on the www.CPACanada.ca website.
The CICA has launched a new online course that provides an overview of the new accounting standards for private enterprises (ASPE). Introduction to Accounting Standards for Private Enterprises provides information about the standards and identifies the significant application issues that should be taken into consideration.

“All accounting professionals should have some knowledge of ASPE, particularly those with private-company clients and those working for a private company,” says Gordon Beal, CICA’s director of guidance and support. “The depth of knowledge you need depends on your current job and future career plans. Some people will find this primer course is all they need; others will view it as a strong foundation for future learning.”

The course takes participants through some of the financial reporting options available to Canadian private enterprises by looking at a sample financial statement. It reviews the standards in use by looking at the balance sheet, income statement and cash-flow statement, identifies the main issues and highlights where to look for further guidance. The one-hour course is available to all accounting professionals free of charge. CAs earn a one-hour continuing professional development credit upon successful completion of the course quiz.

To sign up for Introduction to Accounting Standards for Private Enterprises or for more information, visit http://www.cica.ca/privateenterprises.

Free online intro to accounting standards for private enterprises

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Proveal Inc., located in Milton, Ontario, is a specialty meat processing and packaging company. Opened in 1992 by Willem Vergeer and his wife, Mariska Vergeer, Proveal currently employs some 20 workers in a 14000-sq. ft. processing plant, and markets its product lines to national retail and food service customers in Canada and the United States.

In 1999, Proveal went shopping for an Enterprise Resource Planning (ERP) solution. "We needed an integrated system that would give us optimum information for minimal effort," says Vergeer. "In the food industry, the margins are very tight, and you need to know your costs. In addition, you have to ensure complete food security, as specified by HACCP, the industry-required food safety program."

Proveal's search for an ERP eventually led the company to SYSPRO. "It had everything we needed," says Vergeer, "I'm not really an IT person, but I was amazed at all the things SYSPRO could do."

The implementation of SYSPRO was an important strategic component for Proveal's growth and development. "SYSPRO’s interaction between incoming goods and outgoing finished products has enormous operational value," says Vergeer. "Being able to control our product and our cost with full traceability from every BOM detail has allowed us to position ourselves strategically as a niche manufacturer."

As Proveal realized the power of its new ERP, the software itself became a fundamental selling tool. "SYSPRO is the 'added ingredient' that helps establish the quality of the entire company," says Vergeer. "If we have visitors, we show them the plant, the product, and the way that everything is integrated under SYSPRO."

National retail and food service operations, explains Vergeer, need to have one-hundred percent faith in the quality of their suppliers' products. "Our clients have all been very impressed with the accuracy and detail that SYSPRO provides. Our consistency and full product control gives them confidence in their relationship with us. In addition, we have received very positive comments after every mandatory third-party audit."

Over the years, SYSPRO’s modules have grown with, and even anticipated Proveal's needs. "We rely heavily on full product traceability," says Vergeer, "as well as detailed BOM cost controls, product movement analysis, sales analysis, forecast analysis, historical planning control and SYSPRO’s many other features. They make it possible for us to run a tightly controlled processing facility in a very competitive business environment."

In today's marketplace, says Vergeer, rapid access to information can be critical. "Every day of the week our customers are asking us for information. In addition, industry-required food safety programs, like HACCP, all demand information at a moment's notice. SYSPRO has proven over and over that it delivers full control, confidence, and peace of mind – all at the touch of the button."

In 2010, says Vergeer, by way of example, when the Canadian government listed bisphenol A (used in the manufacture of plastics) as a toxic substance, one of Proveal's biggest customers asked the company if bisphenol A was present in their packaging materials. "If you keep your SYSPRO system updated," says Vergeer, "it's extremely efficient." In this instance, Proveal had the answer within two hours, and the customer was reassured.

"We're proud to be SYSPRO users," concludes Vergeer. "Furthermore, we can state with confidence to our colleagues in the industry that SYSPRO ERP is an excellent ingredient for the success of an organization in the food sector."
CICA presenting new conference on personal financial planning

The fall conference season is in full swing for the Canadian Institute of Chartered Accountants (CICA). Something new for 2011 is the CICA Advanced Personal Financial Planning Conference and Showcase.

CAs in traditional practices and in wealth-management firms serve clients in a variety of ways. The conference includes general and technical sessions covering the latest and most relevant topics.

“The timing is right for this conference with a growing interest in personal financial planning,” says Frank Colantonio, CICA director, continuing education. “The financial crisis impacted the financial well-being of many individuals and there is a growing focus on the financial literacy of Canadians.”

In fact, Cairine Wilson, CICA national practice area leader for financial literacy, will participate in a session on that topic. “Our national survey in 2010 found that Canadians view financial literacy as an essential life skill and that many recognize they can use some help,” Wilson says.

Conference participants also will hear from special guest speaker Harry Markopolos, the Bernie Madoff whistleblower.

Other topics to be addressed at the conference include:
• fiduciary responsibility;
• a scan of the regulatory landscape;
• running a successful personal financial planning practice;
• helping family businesses grow and maintain wealth;
• the income tax implications of investing; and
• options and opportunities for careers in wealth management.

The conference is ideal for CA practitioners and others who provide wealth management and financial planning services. It runs November 7 to 8 in Toronto.

More information is available online at www.cpd.cica.ca/pfpconference.
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RECENTLY ISSUED PRONOUNCEMENTS

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WATCH FOR

New or Revised Standards
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Documents for Comment
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Legend

ED – Exposure Draft  EDI – ED based on IFRS/ISA  RVI – IASB Request for Views
DII – IASB Draft Interpretation  ITC – Invitation to Comment  CP – Task Force Consultation Paper

† Refer to each Handbook pronouncement for the effective date and transitional provisions. The information published above reflects best estimates at press time. Please visit our website for the most recent information.
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With debt levels rising and retirement savings sinking, a lack of financial literacy is costing Canadians big time. Help is needed and CAs are heeding the call.

It pays to know

By Robin Taub & Mary Teresa Bitti

Jim* was 26 years old when he walked into Ted Gordon’s Personal Financial Literacy course at Ottawa’s Algonquin College. Gordon, a CA, has been a financial security adviser with Freedom 55 Financial in Ottawa for the past five years and created the curriculum for the course. “Jim approached me after the course was finished and said, ‘I’m broke,’” recalls Gordon. “I was astounded because he had a job with the federal government.” As it turns out, even though Jim had a good income that should have been sufficient to meet his expenses and save for the future, he had accumulated $20,000 of student debt and thousands more in credit-card debt. He explained to Gordon that when he got the credit card it felt like free money, so he went on a spending spree, buying music and stereo equipment.

“Jim was living paycheque to paycheque until he recognized that he had a problem,” says Gordon. “The fact is, many people experiencing financial difficulty have money; they’re just not handling it responsibly.”

It’s a situation Laurie Campbell, executive director of Credit Canada, a not-for-profit charitable organization providing credit-counseling services and debt-management solutions, knows all too well. In fact, 40% of the cases it deals with are people like Jim who have sufficient income but don’t know how to manage it. “No one ever taught them how to live within their means and they never learned on their own,” says Campbell. Eventually, a life event — such as a marriage or birth...
Research shows half of Canadian adults are not saving enough, setting aside less than 10% of their monthly income, with 25% saving less than 5% or nothing at all.

or a crisis such as an illness, disability, death, divorce or job loss — brings these issues to the forefront.

Take Steve, a Credit Canada client, for example. “He was making a six-figure income, his children were in private school, they had a nanny but the family was cash poor,” says Campbell. “They were not saving at all. They had nothing invested in registered retirement savings plans (RRSPs). Their house was mortgaged to the hilt and as soon as he was laid off there was no cushion to help him over a period of unemployment because every single penny of his income went to service his lifestyle without consideration of what could happen in an emergency. It took losing his job for him to make a change.”

According to Statistics Canada, the average Canadian family carries a debt load of $100,000 and its debt-to-income ratio is at record levels. For every $1,000 in after-tax income, Canadian families owe $1,500. The CICA’s own research shows that half of Canadian adults are not saving enough, setting aside less than 10% of their monthly income, with 25% saving less than 5% or nothing at all. It’s a slippery slope — one with implications for the Canadian economy.

In order to create a national strategy to strengthen financial literacy across the country and in so doing secure the country’s economic well-being, in 2009 the federal government established the Task Force on Financial Literacy. Both Gordon and Campbell were part of the 13-member task force, which included representatives from education, business, not-for-profits and academia, with Gordon serving, along with Jean Vincent, president and general manager of the Native Commercial Credit Corp., as one of two CAs. In February, the task force released its findings and some 30 recommendations — all highlighting the need for collaboration and coordination among schools, governments, financial institutions, employers and labour organizations and, perhaps most importantly, stressing the need for lifelong learning by helping Canadians leverage the variety of programs and resources that currently exist but they may not know about.

The task force defines financial literacy as having the knowledge, skills and confidence to make responsible financial decisions. As a result, among its key recommendations is that Human Resources and Skills Development Canada name financial literacy an essential skill and that financial literacy be integrated into the formal education system, including elementary, high school, college, university and adult learning. The task force also recommended financial literacy training be incorporated into workplace programs.

Jim Yih is a financial educator and founder of Edmonton-based The Think Box, which specializes in financial education programs in the workplace. Creator of retirehappy.ca, his blog was The Globe & Mail’s 2011 personal finance blog of the year. “In my view, financial literacy is a combination of education and skills,” he says. “There is no shortage of information. Everything you need to know to be financially literate is out there, but still 42% of Canadians lack basic financial literacy. Why? Even though the information is available, there is very little formal education around financial literacy. We don’t learn it in school or in the workplace. Instead we learn it informally from our parents and what we are seeing is that most of our parents aren’t doing a very good job either. Until we get to people earlier in a more consistent, unbiased way, things aren’t going to improve.”

That has recently changed in Ontario with the integration of financial literacy into the curriculum for students in grades four to 12 this fall. Manitoba is considering a similar move, as is BC, which has already introduced financial literacy as a mandatory course for high-school students. According to Tom Hamza, president of the Investor Education Fund and co-chair of the Ontario Working Group on Financial Literacy, in Ontario it has started “to be incorporated into topics beyond business and math to ensure that financial learning cannot be avoided.”

Financial literacy isn’t just a set of tools, says Hamza. “It’s a set of actions that will put money in your pocket and improve your financial situation. For example, people renew their mortgage with their original financial institution more than 80% of the time. Most don’t bother comparing what other institutions are offering and that’s the biggest investment of their lives. It just shows there is a very real practical need for financial literacy.”

The bottom line: financial literacy is a necessity in today’s world. The task force believes Canadians must be empowered to make better financial and life choices: to plan better for the future, ride out difficult economic times, protect themselves against financial fraud and navigate major life events. As a nation, this allows Canada to be strong, competitive and successful in a global economy.

A financially literate population promotes self-sufficiency and financial independence, thus reducing the pressure on social programs. It enhances economic stability, strengthens competitiveness and contributes to stronger capital markets.

Understanding personal finances will help an individual save for his or her children’s education, purchase a home, deal with divorce or having to care for elderly parents, make better investment decisions and minimize the amount of income tax he or she must pay. It will help him or her cope with crises and ultimately will help build his or her personal wealth to secure a comfortable future.

As it stands, Canadians aren’t doing such a great job managing their finances. According to research from Statistics Canada for the federal task force, almost 25% of Canadians were weak in keeping track of their finances, planning for the future and
staying informed about financial matters. More than a third were struggling or unable to make ends meet and 30% were not preparing for retirement. They fared no better when it came to basic investor knowledge. Only 35% of Canadians knew investments in the stock market are not insured, while one-third did not know what happens to their buying power when the inflation rate is higher than the interest they earn on their investments.

Kurt Rosentreter, a CA and a senior financial adviser with Manulife Securities Inc. in Toronto, is not surprised by the findings. “It’s safe to say the typical Canadian struggles to understand what’s going on with his or her employer pension plan, investments, mortgage, registered education savings plan [RESP], RRSP, life insurance, will — in other words, the world of personal finance,” he says. “Financial literacy is low regardless of whether I’m dealing with an electrician or a CEO. It’s not a gender thing. It’s not a career thing. It’s not a net worth thing. What shakes them out of that apathy is a life event, like a birth, marriage, divorce, death, career change, and they have to act. But it’s pretty rare that someone is proactive and will spend sufficient time each year on his or her finances. And that will hurt him or her long term.” This is particularly true when it comes to estate planning, investments and insurance, says Rosentreter. “And that’s dangerous because if you don’t know what you are buying it’s easy to be taken advantage of.”

Gordon shares an example of recent clients, a married couple in their 40s, who closed their eyes to the poor performance of their portfolio — literally. “In this case, it wasn’t an issue of not saving. Their RRSPs were losing money every year and they didn’t know what to do about it or what to say to their financial planner. The wife’s solution was to stop opening up the statements,” says Gordon. “Had they stayed the course they would not have been able to retire as comfortably as they should, given their incomes. Most people with a financial plan should tar-
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get around a 5% growth rate each year on their savings, not a decrease. Thankfully, I’ve taken over their RRSPs and they are now making money.”

Demographic, social and economic changes mean Canadians are assuming increasing responsibility for their financial futures and they simply cannot afford inaction. As members of the baby-boom generation retire, there are fewer workers to support them, which strains social programs such as Canada Pension Plan, Old Age Security and healthcare. Due to increases in life expectancy, baby Boomers will be living longer in retirement and will need more savings and other means to support themselves. Fewer Canadians now have access to company-supported pension programs and the majority of those who do have defined contribution plans. This shifts the risk associated with investment management from the employer to the individual employee.

At the same time, the financial marketplace is becoming more complex and financial products are becoming more sophisticated and difficult to understand. Poor financial decisions are simply too costly. Many Canadians are already living with high levels of consumer debt and razor-thin savings.

If there is one typical scenario of the baby boomers walking in his door, Rosentreter says it’s the 50-year-old couple who had not put a lot of thought into their finances beyond making last-minute RRSP contributions and possibly purchasing life insurance. That is, until they woke up one day to realize that all the upsizing of their lifestyle has left them with a six-figure mortgage at the same time they are paying tuition for university-bound children. “What they get from me is a one-time physical examination of their finances and a status checkup of where they are. And it’s rarely pretty,” Rosentreter says. “No one wants to hear they will be working until they are 70 because they have no pension and their savings are insufficient because they’ve been spending every dollar on lifestyle. When people are making $150,000 a year and don’t have money for an RRSP or child’s

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Part of the problem, says Hamza, is that, unlike health issues, which are “personal and immediate, finances are personal, but not always immediate. It’s hard to get people to see the future consequences of decisions they are making today.” In fact, a national survey by Harris/Decima for the CICA reveals that 34% of people surveyed reported carrying a balance on their credit cards, while 12% have borrowed to cover daily living expenses and almost half still owe against these loans. What’s more, 40% of Canadians 55 or older say they have not saved enough for retirement and of those planning to retire in the next five years, 32% believe they have not saved enough.

Why? They simply do not have the cash flow to save for retirement because they’ve taken on too much debt, says Yih. “Just the other day, I was speaking with a 35-year-old couple who have significant credit-card debt. They also have three children and want a bigger house and a new car because theirs is six years old and they feel they should upgrade. So they are willing to go into even more debt to foster a lifestyle they can’t afford. It’s happening everywhere. And the fact that access to credit is so easy and people are content to carry balances on their credit cards, ignoring the double-digit interest they are being charged, means the problem will only continue to grow.”

This lack of basic money-management skills is a concern that goes beyond Canada. The Organization for Economic Co-operation and Development (OECD) has acknowledged that financial literacy is a key contributing factor to prosperity and well-being around the world and that more needs to be done. The UK, the US, Australia and New Zealand have all been developing and implementing national strategies to improve the financial literacy of their citizens.

In the US in particular, one of the legacies of the financial crisis is the realization that the financial well-being of individuals and families is vital to national financial stability. A lack of financial literacy is one barrier that can lower standards of living and limit prosperity and growth. The Financial Literacy and Education Commission has developed a new national strategy to promote financial literacy and education. The strategy sets a direction for policy, education, practice, research and coordination in the financial literacy and education field. It also establishes concrete goals to increase financial literacy and improve financial decision-making by individual Americans and their families as they pursue personal financial objectives. One goal is to increase awareness of and access to effective financial education, while another is to improve the financial education infrastructure.

The US government has created the website mymoney.gov as a resource dedicated to teaching Americans the basics about financial education. In addition, the American Institute of Certified Public Accountants has created the free program 360 Degrees of Financial Literacy (www.360financialliteracy.org) to help Americans understand their personal finances through every stage of life.

The CICA is also focused on financial literacy and wants to help Canadians better manage their own financial destiny and that of future generations. “Protecting and acting in the public’s interest are the top priorities of Canada’s CAs — a mandate that has defined us for more than 100 years,” says Kevin Dancey, CICA president and CEO.

That commitment to advance financial literacy extends to Canadians of all ages from childhood through retirement. The organization wants to help young people but also aid mature Canadians who face rising debt levels or insufficient retirement savings. “The CA profession is eager to help Canadians gain the financial skills, knowledge and confidence to make the best choices for their circumstances,” says Cairine Wilson, vice-president, CICA member services and publisher of CA magazine. “The profession has the opportunity to become a fundamental driver of the economic and financial health of individual Canadians, and in turn, the broader economy.”

Tina Di Vito, CA, head of BMO Retirement Institute and author of 52 Ways to Wreck Your Retirement: … And How to Rescue It, published this fall by John Wiley and Sons Inc., couldn’t agree more. “You don’t need to know everything about complicated investments such as derivatives; for most Canadians financial literacy is really about understanding what they own and owe, and how cash flow impacts net worth,” says Di Vito. “Earlier in my career I worked with an accounting firm and prepared cash flow and net worth statements for people who had taken early-retirement packages. It was a real eye opener for them. It forced them to take a look at all their assets and debts — something many of them hadn’t done before.

“We also reviewed tax returns and that was another clear signal to people because they didn’t think about tax when they made investments. It’s not that they are uninformned necessarily or making bad decisions, they just aren’t connecting how all their financial decisions are interconnected. As CAs we are in a unique position to help because we are involved in so many aspects of a client’s life and we can connect the dots.”

The Harris/Decima-CICA survey revealed that the most sought-after financial literacy skills are tips on minimizing taxes, avoiding fraud and how best to teach kids about money. The CICA is working on a series of online and offline education initiatives to advance financial literacy from childhood to retirement. The online resources will include a monthly e-newsletter and a website that will provide free, unbiased information, material on various key aspects of financial literacy and include interactive
tools and resources. The CICA will also continue to do ground-breaking research.

In addition, the CICA is publishing a book in September 2011 called A Parent’s Guide to Raising Money-Smart Kids to help parents teach their kids about money. According to its survey, Canadians believe that parents have the primary responsibility of teaching their kids about money and many have tried, but most believe they have not been very successful. However, they recognize they need help and are willing to listen and learn.

Finally, the initiative includes community outreach by CAs to deliver seminars on key financial topics at the grassroots level in their communities, local schools and places of employment. Topics include: financial planning, household budgeting, teaching kids about money, tips for minimizing taxes, saving and investing, managing debt and credit and retirement planning. These financial literacy seminars will offer Canadians a hands-on opportunity to learn and have their questions answered. The CICA is also planning to offer electronic delivery of seminars and to archive these webinars on the future website.

The CICA, working collaboratively with the provincial institutes, will provide CA volunteers with presentation materials and resources. If you are interested in volunteering, please contact Wilson at cairine.wilson@cica.ca.

Already there are CAs who are eager to get involved. “A recent CICA member survey indicated that more than half the respondents are prepared to volunteer their talents and time to help improve financial literacy,” says Wilson.

When it comes to financial advice, people prefer to trust than to ask tough questions, says Hamza. “Trust is an easy substitute for hard work, but people often place trust blindly.” CAs, however, have earned the public trust and are known for their financial expertise, independence and integrity — characteristics that uniquely position them to help in the effort to make Canadians more financially literate.

For his part, Gordon is optimistic about the future. With the new Conservative majority government in place, the task force recommendations are set to roll out over the coming months, including the naming of a national leader who will report directly to Finance Minister Jim Flaherty. “This person will be the flag bearer for financial literacy across Canada,” says Gordon. “If we follow through on the report recommendations, Canadians can expect to become world leaders in financial literacy. It’s exciting.”

To read the task force report, including all 30 recommendations, please visit www.financialliteracyincanada.com/Canadians-and-their-money.html.

‘Indicates the name has been changed to protect the privacy of the individual.

Robin Taub is a CA specializing in financial literacy and is the author of A Parent’s Guide to Raising Money-Smart Kids. Mary Teresa Bitti is a freelance writer based in Oakville, Ont.
While most clients are reasonable to work with, some can be more trouble than they’re worth. How do you cull the bad and keep the good?

by John Lorinc

The good, the BAD and THE UGLY

NOT LONG AGO, Belleville, Ont., accountant Bob Robertson, a partner with Wilkinson & Co.’s Quinte West practice, found himself grappling with the problem of what to do about a difficult client. Over the course of a three-year relationship, the client, the owner of a midsized manufacturing company, had lapsed into a pair of habits that were proving to be a serious source of aggravation for Robertson and his colleagues.

illustration by JOE SALINA
First, the individual frequently reamed out the Wilkinson employees who had to work on his books. Just as problematically, Robertson recalls, he attempted to “window dress” his financial results.

The problem of how to proceed, though not common, raised tough questions that most accounting professionals must eventually confront in their career: do they want to associate their practice brand with clients whose conduct may impair their own reputations? And to whom do partners such as Robertson owe their loyalties: a difficult client or the long-suffering employees who have to take one for the team, even if it means putting up with a relentlessly demanding and rude customer?

In this case, Robertson wanted to fire the client, as the saying goes, but the client closed shop before it got to that. Robertson believes making the break with a client should be as straightforward and professional as possible. “You should take the high road and break the news in person,” says Robertson. “You go and meet him and say the relationship isn’t working out.” Then, he adds, “you turn off the clock and make sure you do everything you need to do to ensure that client gets a good transition.”

In a professional services industry such as accounting there are few aspects of practice management more important than creating and maintaining strong client relationships. CAs who set out to recruit and retain high-quality clients are rewarded with solid practices, few conflicts and a profitable book of business. But those kinds of practices don’t grow by accident. They are the product of a highly strategic approach, one that relies on careful prescreening of prospective customers and servicing A-level clients well beyond their expectations — especially in non-Big Four firms.

Experienced CAs also know that they can only build such practices if they understand how to upgrade C clients and are willing to cull the customers who produce far more friction than billing activity. “Keeping bad clients means that over 30 years, you’re going to have a bad practice,” says Robertson.

For many years, accounting practices of all sizes built their client rosters in conventional ways — a combination of marketing, word-of-mouth referrals and competing for corporate audit and assurance service tenders. In good times, growth was the primary objective and many practices weren’t all that selective. “Ten years ago, CAs would say that every client relationship is good,” observes Mark Whitmore, Deloitte’s managing partner for Greater Toronto. “Now, people are asking tougher questions [of prospective clients] because of regulatory issues.”

Among the larger practices that handle public companies, the open-door attitude shifted in the years immediately following the Enron meltdown and the subsequent wave of regulations gov-

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**Adding As and deleting Ds**

Montana-based CPA Sam Allred, a founder of consulting firm Upstream Academy and one of the top recommended practice management consultants in the US, has advised hundreds of firms on how to retain A-list clients and shed the Ds.

He offers the following tips:

**Targeting A clients**

Allred’s academy has developed a profile of ideal clients. These clients share 10 key characteristics, including the ability to: attract and retain quality staff; stress teamwork; invest in technology; recognize and pay for excellent professional service; plan for change; take advice; and occupy secure and profitable positions in their sectors.

He advises practices to build screening tools, based on questionnaires, that reveal whether prospects fit the bill, then to focus only on those types of clients. Allred also says that discipline is very important, because professional services firms are always tempted to sign on customers who are willing to pay. In the years after moving to this approach, Upstream saw its profits rise impressively as the firm adopted this highly selective approach. “We also found that our quality of life substantially improved,” he says, “as these new clients were so much more capable of helping us have successful consulting engagements.”

**Divorcing D clients**

“Abandoning ‘the bad old things’— in our case, D-level clients — is not something that comes easily to many in our profession, but I believe it’s one of the most important things we can do to build our firms,” Allred wrote in an online article titled “Practice management: firing D-level clients, everybody wins.”

Firms end up with D clients because of inadequate prescreening processes, Allred says. But they’re not difficult to recognize once they’re in the fold. Such clients tend to be high-maintenance companies or individuals whose files consume a lot of the firm’s resources and produce high levels of stress for employees.

Many firms avoid culling such clients for fear of conflict or loss of face. But all accounting practices need to actively manage their exposure to risk. And they should not be overly concerned about losing a paying client.

“Saying no to the wrong opportunity positions us to say yes to the right one when it comes along — which it will,” Allred says.

Allred’s five-step process:

- develop criteria for identifying D-level clients;
- set a reasonable goal for removing D-level clients;
- identify specific clients that will be removed this year and assign responsibility;
- schedule a face-to-face meeting with each targeted client; and
- be accountable for following the process. — JL
ering assurance services. Despite warnings from the Securities and Exchange Commission, the Big Four firms during the mid-2000s began aggressively reviewing clients deemed to be either too risky under new accounting rules or inadequately governed.

According to a 2005 report in The New York Times, Big Four firms ended client relationships three times faster in 2003 than they did in 2002, when Congress legislated the Sarbanes-Oxley Act. “Our client acceptance and reacceptance processes,” Ernst & Young chairman James Turley told a Congressional committee at the time, “have been re-engineered with an increased focus on determining which companies we really want as audit clients and culling out those that we do not believe have adapted to the new environment and demands on a public company.”

Big Four firm resignations jumped to 210 from 78 between 2002 and 2004, with second-tier companies picking up some of the newly auditor-less clients. That trend has reversed itself in the intervening years. Audit Analytics, a US consulting firm, reported that Big Four departures dropped by a third between 2009 and 2010; these firms only resigned from a client relationship in about 17% of these cases in 2010.

While these pressures have ebbed somewhat, Whitmore says the environment remains tough and very competitive and the need to be selective is as strong as ever. “Look before you leap,” he says. “Is this a client you want to be associated with?”

Deloitte partners will work their own professional networks to vet prospective clients, using formal and informal background checks, reviews of the executive team and the board, and an assessment of the firm’s business practices. Whitmore wants to find out if they pay their bills and also assesses whether Deloitte’s brand could be vulnerable. “Are they into risky businesses or in countries you don’t want to be associated with, or in industries that aren’t attractive?”

For smaller firms that don’t have the brand recognition, networks are even more critical when enlisting prospective clients. “Many of my best clients are people I went to school with 25 years ago and now run successful ventures after many years of growing pains,” says Andrew Logan, a senior partner at Teed Saunders Doyle & Co. in Saint John, NB. “They are friends, university associates and other businesspeople we have met during our networking activities. We like to think that our advice and coaching over the years has been a key part in their success and for the most part, the clients see it that way too.”

Some smaller or midsized firms have moved to increase their scrutiny of new clients. They typically take a less formal approach, but it’s important to eyeball prospective clients rather than relying on more technical approaches to screening, such as online questionnaires. Logan says his practice will do reference checks and may even place calls to a firm’s former auditors to find out why they’re changing horses. “There is an informal assessment done in which we try to determine the future potential of businesses just starting out.” The process, he adds, is very
Firms should remain attentive to valued clients in good times and bad. “They appreciate that you stick with them”

subjective and a large amount has to do with the personality of the entrepreneur.

For his part, Robertson relies on a prescreening technique that turns on three fundamental questions: does he like the potential client? Does he respect them? And can he trust them? The answers, he says, will help him determine whether the firm will pay on time and maintain complete financial records.

With many accounting practices becoming more selective, senior partners must take extra care to ensure that those new high-value clients remain in the fold. Whether a firm is Big Four or not, says Peter Snelling, national partner, marketplace, at BDO Canada LLP’s Toronto office, “you have to assume your best clients are always at risk.”

For firms that proactively nurture A-list clients, the key early on is to establish a solid relationship marked by clear expectations and a broad understanding of the firm’s business. “We ensure that we service them to the level they want to be serviced,” says Bruce Barran, a senior partner at Davis Martindale LLP, a London, Ont., firm.

Other CAs make sure they take time at the beginning of a relationship to understand precisely what the high-value client wants. “It’s important to have that conversation up front so the expectations are clear,” says Carl Oxholm, a partner with PricewaterhouseCoopers in Toronto. “Quality communications will dovetail directly with the quality of the relationship.”

Robertson and his partners at Wilkinson stress what he calls the power of habits in establishing solid relationships from the beginning. Wilkinson staff, he says, is reminded to take care to do four basic tasks for every customer: be punctual; do what you say you’re going to do; bill what you’ve agreed to bill; and say thank you. “What you’re saying to that client is that you respect your relationship,” he says.

But beyond such decorum basics, Robertson says firms must work to create value in the relationship. That means engaging clients in frank and broad-ranging discussions about both their goals and the problems they’re looking to solve. “People want to talk,” he observes. Among his questions, Robertson asks clients to envision where they want to be three years hence in order to get them to focus on longer-term goals. When discussing solutions to lingering tax or balance-sheet issues, he stresses that some problems will only be resolved over time — a signal to clients that his firm wants to develop a long-term relationship. “If you want to deal with high-net-worth people,” he says, “you have to find out where they want to go.”

With his A clients, says Logan, the firm’s approach is to “service them to death” and always exceed expectations. The firm, for example, will not have junior accountants handle important accounts on their own and there’s a strong emphasis on timely communication. “When they call,” he says, “we call back fast.” Logan also makes a point of always asking clients how their business is doing — and not just to make small talk. His message: he’s genuinely interested in the well-being of a client’s company.

With their best clients, some practitioners take that attentiveness to the next level, taking the time to inquire about their customers’ families. “You really need to get to know the person, not just on a business basis, but personally,” says Ray Kolla, the office managing partner at KPMG in Victoria. He and his spouse have forged long-standing friendships with key clients — connections that include ski holidays and other social events. “It’s amazing the amount of understanding that develops when you really get to know what makes them tick,” he says. Kolla further solidifies those connections by encouraging members of a team to forge and maintain contacts with several members of a client’s team — not just the CFO. That way, the relationship doesn’t depend on a single individual.

But the care and feeding of strong client ties goes beyond a lot of professional TLC. Large firms often augment their service offering for high-value clients by taking extra steps to ensure they’re delivering precisely what the customers expect. Part of the answer involves the composition of the team assigned to an important customer, says Whitmore. “You always need to challenge yourself: is this the right team that’s bringing industry insights that matter to the client?”

After the fact, Whitmore adds, Deloitte will bring in outside partners who can review with the client how the team delivered the service and whether there’s room for improvement. He recalls a recent such post-mortem during which the client revealed that it wanted someone else on the Deloitte team who had a wider focus than just accounting issues.

Whitmore also points out that firms should remain attentive to valued clients in good times and bad. When a customer is experiencing financial difficulties and is dialing down its spending on professional services, it’s still important for accountants to keep lines of communication open, being careful not to waste clients’ time. “They appreciate that you stick with them even when they can’t buy your services,” says Whitmore. “If you abandon your clients at those points, you may not be the first ones to get a call back when their finances improve.”

At the other end of the practice spectrum are the D clients, the ones who, like a whining child, work very hard to attract attention, disrupt the practice, stress the employees and turn out to be expensive to service for various reasons — their books are disorganized or they hand over their records three days before the tax-filing deadline and expect their accountants to drop everything to get the return to the Canada Revenue Agency before the clock runs out.

Veteran practitioners say a relationship often sours because of a mismatch of expectations regarding service levels, deadlines, fees and even the composition of the team working on the cli-
ent’s file. “Sometimes clients have expectations that aren’t consistent with the service you can provide for the price they want to pay,” says Snelling, who adds that this dynamic is one of the most common sources of friction and customer-relationship breakdown.

Logan says he has seen cases where the firm has sought to salvage a deteriorating relationship by moving the lead partner off the file because of chemistry problems with the customer. “That’s a tough conversation to have, but you have to do it,” he says. “Sometimes the client wants a fresh face.”

Whatever the cause, the signs aren’t difficult to recognize. A client may stop calling on a regular basis, drag its heels when processing invoices or begin questioning every accounting decision. “When they’ve lost confidence in you or are second-guessing you, that’s when you lose the trust factor and that’s when you evaluate the relationship to decide if you want to distance yourself,” says Barran.

In such situations, Kolla believes that accountants have to be very direct with their clients, warning them to curtail problematic behaviour, such as abusing junior accounting or secretarial staff. “You have to risk the relationship,” he says.

Snelling agrees it’s important to try to work through problems in person, showing the client what’s not working and pointing to solutions that are mutually agreeable. “Your mother or father would say, ‘don’t let things fester,’ ” he says.

Once they’ve decided to divorce a client, firms can take various approaches to making the split. But, Whitmore observes, “If you proactively have to exit a relationship, make sure you do it in a professional way.”

Some firms use their fees to send the message. They bill clients for the time and aggravation they cause, says Barran. “Then these clients tend to leave.” In other cases, firms may simply opt not to bid on tenders for audit services. But such moves will invite questions from clients.

When a firm has made the decision to fire a client, however, veteran accountants say it’s important to see the disengagement process through to the end, even if it becomes uncomfortable. Logan recalls a client who was heading down a path that was borderline illegal. He and his partners at Teed came to the conclusion that they would terminate the relationship and wrote a letter to the client, explaining the decision.

Three days later, he says, the client called up, expressing contrition and begging Logan to change his mind. “We held to our guns and he went bankrupt nine months later,” he says. Indeed, the client’s desperate reaction was, in effect, an admission that the company wouldn’t be able to find another auditor because it was so overwhelmed by irresolvable financial and accounting difficulties. “It consolidated our decision that we didn’t want this guy [in the practice],” Logan says.

But most experienced accountants say that such confrontations are rare — in the vast majority of cases, pragmatism will prevail because firms know they need these professional services. As Robertson says, “There are a million great clients out there and very few that are people I would not want to deal with.”

For all the good and bad attention paid to the As and Ds, Grant Galbraith, managing partner of Collins Barrow’s Dartmouth, NS, office, observes that most of the clients of a typical practice actually fall somewhere between those extremes. The companies that make up that large middle group, he says, “aren’t sexy, but are a big part of the practice. They’re the ones who are telling two friends.”

In Galbraith’s view, the key to maintaining a solid and enduring book of business is to turn D clients into Cs, and Cs into Bs. In fact, Galbraith’s experience has shown that it’s often easier to push a C client into the B column — by finding additional ways to deliver service and managing expectations — than it is to fire the client and find another B. As he says, the mere fact that there are problems with some accounts — they’re slow payers or have chronically disorganized files — “doesn’t mean I don’t like them or respect their businesses.”

John Lorinc is a Toronto-based writer

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John Lorinc is a Toronto-based writer
Keep a skeptical edge

Familiarity with a client and the self-review threat don’t have to impede an auditor’s performance

A professional auditor is trained to be skeptical from his or her first day on the job, and he or she needs to maintain this skepticism throughout the course of every audit. In larger engagements, safeguards are put in place to ensure that skepticism is always reinforced: a junior auditor’s judgments regarding audit evidence are questioned by the engagement audit senior, whose judgments in turn are questioned by the audit manager, whose judgments are in turn questioned by the audit partner, and so on.

While there are mechanisms to promote skepticism in multiperson audit engagements, ensuring skepticism during the audit of a micro-entity, when the auditor often works alone, is not as straightforward. For example, consider this situation. An auditor, engaged by a client for the past few years, expects to perform the audit engagement alone. The client is run by an experienced executive director, who is also in charge of finances, and an active board of directors that has experience in governance. Management asks the auditor to help draft the annual financial statements. There has not been a lot of change in the client’s sector over the past year and the numbers in that year’s trial balance appear reasonable. Overall, this audit appears to be low risk and the auditor expects to complete the engagement in a day or two.

In this scenario, what should the auditor do to ensure a sufficiently skeptical attitude, especially when receiving information and answers from management and following up unusual trends? More specifically, how will the auditor meet the standard of skepticism required in every audit? To answer these questions, it is important to understand skepticism requirements.

The relevant audit requirement regarding skepticism is stated in Canadian Auditing Standards (CAS) 200.15:
“The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.”

This principled requirement is supported with application material in CAS 200 A18 to A22, which explains why skepticism is important to an auditor’s success, also laying out some limits of an auditor’s responsibilities: “The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity’s management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less than persuasive audit evidence when obtaining reasonable assurance.”

And therein lies the problem. How does an auditor working alone maintain a skeptical edge while auditing a very small entity? This requires that an auditor overcome the power of suggestion and familiarity with management and those charged with governance, believing they are honest and have integrity thanks to past experience. (See www.youtube.com/watch?v=obG7EFhMw8w for a demonstration of the power of suggestion.) As a result, unless sufficient safeguards are in place in such an environment, an auditor may too readily accept the information and answers and fail to follow up unusual trends.

One of the great benefits of partner and staff continuity on any audit is the specific knowledge that the independent auditor...
learns over time and applies to that engagement over the years. As well as making for an efficient audit, having past experience can both facilitate good communication and make it easier for an auditor to spot problems and make workable recommendations for changes when needed.

While the Chartered Accountants’ Code of Conduct mandates partner rotation for listed public entities, partner rotation is not required for micro-entity audits. The benefits of staff continuity generally outweigh the danger of familiarity, provided adequate safeguards are in place to guard against a threat to independence. Having adequate safeguards is especially important if the auditor is working alone.

The challenges faced by an auditor working alone and second guessing his or her work must be overcome. For example, assisting management in statement preparation is seen by clients as a value-added service and is common in many micro-entity audit engagements. Helping management prepare statements that the auditor will then audit typically does not pose a significant threat to independence, provided there are few or no difficult accounting judgments required for statement preparation, which is often the case with micro-entity financial reporting. However, an auditor must nonetheless have adequate safeguards in place to guard against the self-review threat, as micro-entity management usually has little to no understanding of the financial report framework and relies heavily on the auditor’s expertise.

Safeguarding the skeptical edge while auditing micro-entities

Ensure pre-conditions for engagement acceptance are in place (CAS 210.06) Not only may micro-entity management not have a good understanding of the financial reporting framework and ask the auditor to have a significant role in statement preparation, but management also may not understand that it is ultimately responsible for its financial statements. As a result, the auditor must first determine whether management is capable of accepting that responsibility before starting the audit. Key elements of management’s taking responsibility are understanding and approving the information in those statements.

It is at the engagement acceptance stage that the auditor should also consider whether there are sufficient safeguards in place to mitigate the self-review threat. This is the time to ask such questions as: what significant judgments are required for statement preparation? Are any of them unusual for this type of client? Are there likely to be any management biases? Are the reporting deadlines unusually tight?

To help the auditor determine if his or her judgment is sound when forming his or her audit opinion at the end of the engagement, the auditor should determine if:

- there may be any inconsistent evidence, unreliable documents and answers to questions or evidence of management bias;
- communication with the client throughout the audit has been satisfactory; and
- there have been any unreasonable delays in obtaining information.

Know the client’s business

A significant factor in evaluating the persuasiveness of audit evidence is being able to compare it with expectations, which helps the auditor look out for danger signals. It is essential to know enough about a client and its business to develop meaningful expectations, such as the expected ratio of staff costs to revenue, cost-of-sales to sales, or investment income to investments. It is critical to establish an acceptable range outside of which additional audit procedures would be required.

An auditor is required to perform analytical procedures at the beginning of every audit to assist in the identification of risks of material misstatement (CAS 315.06) and must also perform a similar task prior to signing the audit report (CAS 700.11). The auditor should document his or her thought process used to arrive at the original estimates, and his or her conclusions when comparing actual results with those estimates. If an auditor’s work is not reviewed by someone else, it is important to be careful to ensure there is sufficient appropriate audit evidence to explain the unexpected and that documentation reflects an appropriate degree of professional skepticism.

Introduce an element of the unexpected into every audit

Audit standards require introducing an element of the unexpected in every audit. Spending time obtaining additional audit evidence over and above what would normally be obtained could unearth an industry insight or an unsuspected area that requires additional audit emphasis, and perhaps a control improvement. Examples of additional work could include an increased focus on payroll processing, expense report documentation and approval, approval of electronic payments, computer backup and security procedures or the budget process.

Periodic file review

The quality control standard for firms requires that every engagement partner have an independent monitoring review of an assurance engagement file normally no less than once every three years (CSQC1 48(a) and A66). This requirement helps ensure that judgments and evidence of professional skepticism are adequately documented. File review can only strengthen every engagement partner’s professional performance, especially when the auditor performs engagements alone. Having one file reviewed every three years is likely not frequent enough, especially where an auditor’s work is not often reviewed by a second person.

Summary

Micro-entities can obtain many benefits from an audit, especially if it is conducted by an auditor with prior experience with the entity and the industry. Despite the fact that familiarity with a client and the self-review threat can pose problems to maintaining skepticism, taking a few steps can result in adequate safeguards, a solid audit and a successful engagement.

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A holistic view

As the distinctions between governance, risk and compliance become clearer, organizations are taking an integrated approach.

The beginning of the 21st century was marked by a series of financial scandals that brought the importance of corporate governance to the fore. Infamous examples include the Enron (2001), WorldCom (2002) and Parmalat (2003) debacles.

In an effort to rebuild investor confidence, the US — with Canada, Europe and Japan following suit — enacted the Sarbanes-Oxley Act (SOX), which compelled publicly traded companies to overhaul their governance processes. The sudden interest in the principles of good governance also had an impact on government organizations. In 2006, Quebec adopted SOX, respecting the governance of state-owned enterprises.

In reality, the type of governance imposed by legislation remains an abstract concept for many business managers. For many, compliance with SOX means implementing a laundry list of controls. But many professionals in this area quickly realized that compliance with SOX-like regulations was seen as a simple expenditure.

In the wake of the events of the past decade, governance has become a major issue in businesses around the world. However, the term is used indiscriminately, often in a confusing and even contradictory manner. Governance is viewed as the exclusive domain of boards of directors, but it is also applied to an organization’s overall internal structure. The term “governance” is also used in specific areas, such as project governance, information systems governance and even data governance.

Regulations are not very explicit on how governance requirements should be implemented. For this reason, practitioners turned to a widely accepted reference in the business community, i.e., the Committee of Sponsoring
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ISO 38500, the standard for IT governance, describes governance as a system that involves “evaluating and directing plans for the use of IT to support the organization and monitoring this use to achieve plans,” a definition modelled on the Australian IT governance standard AS 8015.

It can therefore be assumed that by including the notions of structure, processes and monitoring, the OECD and its counterparts added to the confusion regarding the concepts of governance and enterprise risk management. COSO’s enterprise risk management (ERM), the main reference on the subject, includes ERM components such as objective setting, management processes and monitoring activities. It is intended as a means for improving corporate governance.

All the concepts presented thus far demonstrate how the word “governance” can refer to a wide range of definitions, encompassing both the overall organizational structure and the specific roles of the highest levels of a hierarchical structure. Sorting out the confusion remains a challenge, which is why an additional concept known as compliance should be discussed.

In everyday language, the term “compliance” is associated with adherence to capital market regulations, but there can be more to it than that. According to the COSO ERM framework, compliance is one of the four categories of objectives associated with an entity and means complying with applicable laws and regulations. This definition is consistent with the CICA’s definition, although the CICA’s includes standards and internal policies. The interpretation proposed by the Open Compliance & Ethics Group (OCEG) offers a more articulated version of the preceding concepts. In addition to compliance with legal and regulatory requirements and internal procedures, the OCEG refers to the ability to prove such compliance. In short, compliance is presented as evidence that day-to-day operations adhere to the framework that was set for them.

The OCEG is the author of a framework issued in 2009 that promotes the governance, risk and compliance (GRC) concept. The term was coined in the mid-2000s with the intention of highlighting ties between these three concepts. Currently, GRC is mostly associated with IT solutions. Nonetheless, it is interesting to note that these three concepts are part of one principle.

### Value creation cycle

Whether the concept is called GRC or corporate governance, it defines governance as a structured way of managing an organization. This management structure is based on the organization’s objectives, which are themselves based on stakeholders, as well as the internal and external environment. The correlation between strategic objectives and the governance framework is fundamental. And while it may seem obvious in theory, this correlation is often absent in practice.
Each objective comes with its share of risks, a basic one being the risk of not achieving the objective. Some risks are directly related to strategic objectives, for example the risk to the enterprise’s reputation in a market penetration context. Other risks are from indirect sources, such as the risk to production capacity in the event of a very successful marketing strategy. They could also arise from the risk management strategy itself, for example, a subcontract to increase production capacity that creates new financial and operational risks. These examples show that enterprises operate in a risk-filled environment, making it difficult for them to undertake a relevant risk analysis.

Risk management should not seek to reinvent the wheel. While it can be opposed to the more intuitive traditional management approach, its ultimate goal is to propose a more structured logical and consistent approach. In both cases, the strategies adopted define the business model and internal processes. Today, managers are required to better demonstrate and defend the decision-making process leading to the development of strategies, and thereby the implementation of the organization’s objectives. This is where a methodology for enterprise risk management, such as the COSO ERM, can help to achieve sound governance.

In short, a structure of processes, procedures and activities, combined with a corporate culture and policies, is used to manage the organization’s internal and external risks arising from strategic objectives and management decisions. Eliminating an organization’s risks entirely is obviously impossible, and doing so would even be detrimental because without risks there are no opportunities. The purpose of risk management is therefore to establish the structure that will enable the organization to maintain an optimal risk level in order to achieve its strategic objectives. Thus, taken as a whole, strategies are the organization’s governance framework, illustrated in the diagram on page 36 by the circle on the left.

No discussion on governance would be complete without referring to compliance with the governance framework. The compliance principle is illustrated by the circle on the right in the diagram on page 36. The OCEG definition that was referred to previously underscores the importance of being able to demonstrate such compliance.

The purpose of internal control mechanisms is therefore to ensure that risk management strategies comply with the governance framework. In other words, they provide support for effective and efficient strategy implementation. Remember why conducting quality-control reviews of financial results is considered important; why we want to know the level of customer satisfaction; why measuring the rate of spoiled units on an assembly line is important; and why employee performance evaluations are made. All these measures are intended to verify whether business strategies allow organizations to achieve their objectives.

To conclude, the diagram on page 36 also shows that attesting to compliance with the governance framework involves using measurement tools, which can be a traditional internal or external audit process, or automated control mechanisms to measure traffic on a computer network or a call centre’s response time, for instance.

Other methods such as continuous audit or self-evaluation can also be applied. All in all, measures can be selected based on the strategy’s importance and the tool’s technical feasibility. Compliance measurement essentially serves to provide managers with the information they need to adjust their management strategies according to everyday events. This iterative principle is the basis of continuous improvement intended to optimize strategies and corporate governance.

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A question of quality

Has the quality of Big Four audits declined over time?
The evidence might help dispel the conventional wisdom

Recent highly publicized financial reporting failures that roiled the capital markets in Canada, the US and elsewhere have led to the widespread perception that there has been a decline in the quality of audits done by Big Four accounting firms. However, emerging research implying that Big Four audit quality has actually remained stable over time contradicts this impression. Indeed, Jere Francis (2004) surveys the extensive prior evidence that the Big Four provide better audits to their clients than smaller audit firms. More recently, our analysis of the frequency with which public companies commit accounting fraud suggests that Big Four firms continue to outperform smaller audit firms, including in the years surrounding the major financial reporting scandals. In short, a spate of frauds by large companies in the late 1990s and early 2000s created an incorrect impression that Big Four audit quality had fallen over time.

Many commentators and regulators interpret the steep upward trend near the turn of the century in accounting irregularities by companies with Big Four auditors as almost conclusive evidence that their assurance services have deteriorated over time (Coffee, 2002; Imhoff, 2003; Zeff, 2003). Although their perspectives diverge on the main causes, several commentators share the perception that Big Four audit quality has gradually eroded over time relative to smaller public accounting firms. In another common denominator, they almost invariably rely on the surge in accounting frauds committed by public companies with Big Four auditors to motivate their prescriptions for strengthening corporate financial reporting.

For example, John Coffee (2002) stresses that legislative changes throughout the 1990s may have diluted the incentives for partners in the Big Four firms to monitor each other’s work. He argues that Big Four audit quality in the US largely began to decline with the passage of the Private Securities Litigation Reform Act of 1995 that replaced joint and several liability with proportionate liability, which restricts investors’ recourse against external auditors. Although the act was its most visible lobbying success, the Big Four used their political clout on Capitol Hill to initially deflect the Securities and Exchange Commission’s (SEC) proposals to seriously restrict nonaudit services to audit clients (Mayer, 2002). In fact, another standard explanation for the apparent slide in Big Four audit quality is that they were pursuing consulting revenues to the detriment of auditor independence. The rise in nonaudit services may matter more to the Big Four that generate a larger fraction of their revenues from this source (e.g., Ruddock et al., 2006). Indeed, the SEC (2000) explains that its proposals to ban nonaudit services would primarily affect the Big Four that increasingly relied on these revenues in the period leading up to the Sarbanes-Oxley Act (SOX) of 2002.

In a climate of fierce competition for consulting contracts, internal controls over their audit practices may have begun to unravel with the Big Four becoming more tolerant over time toward aggressive financial reporting by their clients. In short, this argument suggests that the Big Four were so eager to secure lucrative...
consulting contracts that they succumbed to pressure from clients (e.g., Coffee, 2002; Healy and Palepu, 2003; Imhoff, 2003; and Zeff, 2003). The Panel on Audit Effectiveness, appointed by the Public Oversight Board (POB) in 1999 at the behest of the SEC, reports that 80% of Big Four clients in 1990 paid no consulting fees to their auditors. This situation changed dramatically with the Big Four’s revenues from consulting practices growing from 13% in 1981 to 33% in 1993 to 51% in 1999 (SEC, 2000). Moreover, the POB (2002) charges that the Big Four strongly opposed its plans to introduce steps to improve oversight of audit practices.

Although commentators identify somewhat different potential explanations, Francis explains that nearly all conclude that the relative quality of financial statements audited by the Big Four firms had begun to fall in recent years. We analyzed the validity of this perception, which involves distinguishing between the relative performance of the Big Four and non-Big Four audit firms in preventing companies from orchestrating accounting fraud. This setting reflects that several commentators develop their arguments on the underlying reasons for the apparent erosion in Big Four audit quality by highlighting the prominent cases of fraudulent financial reporting by their clients (e.g., Coffee, 2002; Cox, 2003). In other words, this is an opportune testing ground for our research on the link between Big Four audits and accounting impropriety.

Identifying the determinants of accounting fraud is important given that the social and economic fallout from these events can be massive. For example, Jonathan Karpoff et al. (2008) estimate that the average company subject to SEC enforcement for financial reporting violations loses about US$381 million in share value through legal and reputational penalties. They also find that for every misrepresented dollar in their financial statements, firms implicated by the SEC lose US$36¢ in fines and class-action settlements and another US$2.71 in reputational damage. Moreover, this analysis is conservative since it ignores the severe reputational penalties incurred by individual managers and directors (e.g., Desai et al., 2006, and Fich and Shivadasani, 2007) as well as auditors (e.g., Carcello and Palmrose, 1994).

Against this backdrop, we provide the first rigorous evidence on whether companies are less likely to commit accounting fraud if they are audited by Big Four firms or whether the relative quality of financial statements audited by Big Four firms has declined over time (Lennox and Pittman, 2010). This involves initially isolating whether Big Four audits lower the incidence of accounting fraud. Observing this negative relation is a necessary condition to justify examining another two questions that provide our main contribution to extant research: does the negative relation between the presence of a Big Four auditor and fraud likelihood persist over time? Is the negative relation explained by Big Four auditors supplying higher-quality audits, or by the endogenous effects of screening by auditors and selection by their clients?

We begin analyzing these issues by reporting univariate evidence, which involves describing a single variable, fraud frequency, over time. For the entire 1981 to 2001 sample period, the incidence of accounting fraud is 0.61% in Big Four clients and 0.92% in non-Big Four clients. The difference between these frequencies is highly statistically significant, reinforcing prior research that brand-name auditors are associated with more reliable financial statements (Francis, 2004). We then examine whether the negative association between Big Four audits and accounting fraud remains stable over time. Univariate tests reveal that the associations are negative and statistically significant in nearly every year between 1981 and 1995. However, there is an abrupt change after 1995 with the relation between Big Four audits and fraud becoming insignificant between 1996 and 2000. Additionally, the association becomes significantly positive in 2001, suggesting that the clients of Big Four firms are more likely to commit fraud than are the clients of non-Big Four firms in the year before SOX was enacted. Collectively, the univariate evidence supports claims that Big Four auditors were no longer outperforming smaller audit firms in constraining accounting fraud in the years immediately before the major legislative and regulatory reforms.

Next, we rely on multivariate analysis to more rigorously isolate the role that auditor choice plays in accounting fraud.

For every misrepresented dollar in financial statements, firms implicated by the SEC lose US$36¢ in fines and settlements and another US$2.71 in reputational damage

Consistent with the univariate tests, we find strong, robust evidence that companies with Big Four auditors are less apt to engage in fraudulent financial reporting over the full sample period. Our results imply that hiring a Big Four auditor translates into the client being about four times less likely to perpetrate accounting fraud, reflecting the first-order economic impact on audit quality. We also report multivariate evidence on the stability of the negative association between Big Four audits and accounting fraud over time. Similar to the univariate analysis, we find significant negative associations in the period from 1981 to 1995. More importantly, the multivariate results include significant negative associations in the period from 1996 to 2001, which is inconsistent with both the univariate analysis and with claims that the Big Four quality differential had fallen in the years leading up to SOX. The negative Big Four coefficients are also nearly identical in magnitude in the 1981 to 1995 and 1996 to 2001 time frames. Moreover, we find strong negative relations between the presence of a Big Four auditor and fraud throughout our sample period. Overall, the univariate results suggest that the negative relation between Big Four audits and accounting frauds vanishes after 1995 while the multivariate results indicate the opposite, i.e., that there is no such structural break. Additional tests demonstrate that the apparent structural break in the univariate results stems from the lack of a control for company size. Corroborating prior studies (Desai, 2005), we find that larger companies were increasingly likely to engage in accounting fraud after 1995. Consequently,
the apparent decline in Big Four audit quality after 1995 actually reflects the increasing tendency for large companies to resort to accounting fraud.

Our evidence implies that the Big Four firms narrow the scope for companies to fraudulently exaggerate their earnings. However, this casual inference that the Big Four genuinely conduct better audits would be premature without considering whether alternative explanations are responsible for our results. For example, Big Four auditors may be more adept at screening the companies that are most likely to commit fraud. Another competing explanation is that companies planning to commit fraud are less likely to appoint Big Four audit firms. We shed light on these issues by examining auditor changes before and during the fraud years. Our results fail to support either of these alternative explanations. Specifically, we find no evidence that Big Four firms are more likely to resign from clients that engage in fraud, which is inconsistent with the screening argument. Similarly, the results do not suggest that fraud companies are less likely to switch to Big Four firms, which is inconsistent with the selection argument.

Contrary to recent widespread criticism of the Big Four firms, we provide compelling evidence that overall rates of fraud have always been low (less than 1%) and that Big Four firms were consistently associated with a lower incidence of accounting fraud than other audit firms, even in the years shortly prior to the sweeping corporate governance reforms. Importantly, our analysis reveals that the sharp rise in accounting frauds committed by Big Four clients in the late 1990s and the early 2000s is simply an artifact of company size. This evidence helps dispel the conventional wisdom that interprets the sudden surge in fraud as almost smoking-gun proof that the relative quality of Big Four audits had fallen over time. From a policy standpoint, our research provides some preliminary support for the position that regulators should focus on the increasing tendency for large companies to commit fraud, rather than blaming the increase in accounting fraud on the Big Four firms.

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Economists wield considerable influence in our society. Prime Minister Stephen Harper is an economist. Most elections, both federal and provincial, hinge on the economy. That is why it is important to understand how economists think, because they are the ones who shape the debate in this regard.

Adam Smith, an 18th-century Scottish philosopher, developed the key concepts that make up modern economic thought. His doctrine was structured around the concept of *homo economicus*, which holds that our economic decisions are rational and maximize self-interest.

Modern market economic thought that presides over the wealth distribution process is based on this concept of rationality. Markets, through the action of Smith’s “invisible hand,” are held to be the most effective mechanism to balance the interactions of an individual’s interests and allocate limited resources for the well-being of society as a whole.

However, this vision is increasingly challenged, particularly by behavioural economists. Assuming complete rationality is unrealistic, but it often leads us astray. Smith’s basic postulate — the *homo economicus* — does not exist. Our decisions are not purely rational and are often influenced by our emotions. Moreover, we consider other aspects than interests when making economic decisions. For instance, *homo economicus* would never give a tip to express gratitude. It is now clear that the invisible hand makes mistakes, and markets send bad signals.

During the Renaissance, philosophers broke away from the biblical vision of the universe, with the Earth as its centre and a world created in seven days. They developed a vision based on a round Earth that revolves around the sun, the concept of gravity and the dynamics of evolution. Making the shift wasn’t easy: Galileo, the best known of them, ended up being imprisoned for his beliefs.

Economists today are in a similar situation. The ideology of the *homo economicus* is seen as misleading. More economists are seeking a new concept to better reflect the reality of human behaviour and economic relationships.

Edmund S. Phelps, winner of the Nobel Prize for Economics in 2006, has proposed the concept of *homo innovaticus*. Like his ancestor *homo economicus*, he is a trader, exchanging goods and services. Very much part of society, he cares about his interests and also the common good. Moreover, curious and unsatisfied with the status quo, he looks for new solutions, which sometimes leads him to make mistakes. *Homo innovaticus* does not have the narrow mind of *homo economicus*, who only focuses on markets.

Toward the end of his life, renowned British economist John Maynard Keynes cautioned us to be wary of the sometimes misleading teachings of dead economists. The 2008 financial crisis proved him right. Its origins lay in the rapid deregulating of the US financial sector. That move was strongly supported by influential economists, who believed it would enhance the effectiveness of capital markets and assumed that financial markets would self-regulate. The opposite happened. Deregulation fed man’s greed and led to the most severe crisis since the Great Depression. Economists may have said, “oops, we’re sorry the markets failed” to the 100 million unemployed who paid the price of the crisis. But the damage was done.

The intellectual foundation of economic theory is being revisited, incorporating behavioural economics and assuming a different finality for all economic activities, namely a quest for happiness as opposed to the accumulation of wealth. It takes into account social concerns and social capital created by human interactions. It accounts for creativity and innovation, which are as important as accumulation and redistribution of wealth. But this new paradigm isn’t fully formulated yet. Meanwhile, be wary of economists still preaching Smith’s market ideology.

Marcel Côté is founding partner at SECOR Consulting in Montreal.
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