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Managing costs

In today's rapidly-changing business environment, many companies are recognizing that, to achieve and sustain competitive advantage, they must focus more attention on the customer. As a result, many have changed their strategies, structures, and processes, leading to a dramatic increase in customer satisfaction. Although these companies may now have a better understanding on how to provide value to their customers, they are far less effective in deriving value from them. According to authors Marc J. Epstein, Michael Friedl and Kristi Yuthas, most companies have great customer diversity, with some customers being highly profitable to the company and others being enormously unprofitable. The recognition of differences in customer profitability by senior financial managers and the use of available tools are critical to a company's ability to derive value from its customer investments. Epstein, Friedl and Yuthas join *Management* this month with their article "Managing customer value" — based on a recent *Management Accounting Guideline (MAG™)* available at www.cma-canada.org.

Business managers continue to hear about the changing and maturing Canadian workforce and are challenged to seek new ways to attract, train, and engage a demographic that includes highly trained foreign professionals. Teresa McGill joins *Management* this month with a look at how hybrid communication training for foreign-trained professionals is becoming a popular approach for career development. Often, foreign-trained professionals miss out on leadership opportunities and career advancement, despite their significant attributes. As a result, frustration sets in, and companies often lose the people they need most. McGill discusses how employers can resolve this dilemma by combining linguistic and interpersonal-skills training.

For the past few months, the business community was hoping the IT industry might be spared of the credit crunch fallout on the basis that technology is a vital link to customers, business partners, and ultimately, a company's bottom line. Given the economic climate, business leaders are now facing increased pressures to reduce their IT costs. As Jacob Stoller explains in "A leaner IT — seven targets for waste reduction," a sensible approach is to identify and eliminate the waste in a company's IT department. This includes finding activities that don't add value to the company and eliminating them. While cutting costs is one of the first actions to take during economic uncertainty, it's important to look at the cost/productivity equation — how to reduce costs while increasing operational efficiency and competitive advantage.



Andrea Civichino
Editor-in-Chief



Publisher Suzanne K. Godbehre
Vice-President, Public Affairs and
Communications
(905) 949-3106
sgodbehre@cma-canada.org

Editor-in-Chief Andrea Civichino
(905) 949-3109
acivichino@cma-canada.org

Art Director Sean O'Rourke
(905) 949-3132
sorourke@cma-canada.org

**Translation and
Co-ordination** Joanne Beauchamp
Hélène Arseneault
(514) 878-1105

Advertising

**National
Advertising Sales** **Dovetail Communications Inc.**

30 East Beaver Creek Road
Ste. 202
Richmond Hill, ON
L4B 1J2
Phone: (905) 886-6640
Fax: (905) 886-6615
www.dvtail.com

Sales Manager Beth Kukkonen
bkukkonen@dvtail.com

Account Manager Robyn Cooper
rcooper@dvtail.com

President Susan A. Browne
sbrowne@dvtail.com

Insertion orders and advertising materials are to be sent to: Crystal Himes
chimes@dvtail.com Dovetail Communications Inc., 30 East Beaver Creek
Road Ste. 202, Richmond Hill, ON L4B 1J2, Fax: (905) 886-6640

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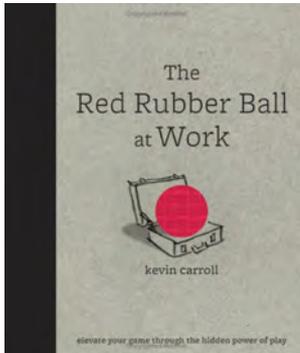
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Learning and improving

The Red Rubber Ball at Work

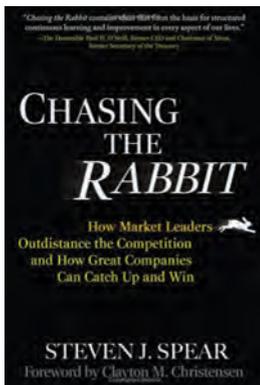


In *The Red Rubber Ball at Work*, Kevin Carroll shows business readers how to apply the same skills they used when they played as kids to invigorate five key hot-button issues in the workplace — innovation, results, teamwork, leadership, and curiosity. He includes over 30 “play profiles” from successful business people whose success comes from

embracing a sense of play at work. Each part ends with an action plan that encourages readers to invoke play in each specific topic, including exercises and other mental activities they can use to stretch their play. *The Red Rubber Ball at Work* also shows how the most enjoyable and beneficial elements of childhood play can actually solve some of the biggest problems companies face. Where other management books call for play-like activities away from the office in the form of company-sponsored sporting events, off-site bonding meetings, and isolated brainstorming sessions, Carroll acknowledges that play and work can be used to achieve the same.

Kevin Carroll. McGraw-Hill.

Chasing the Rabbit



With news headlines of bankruptcies, layoffs, and acquisitions, today’s business leaders are under pressure to maintain and increase performance. Although one of the first “success factors” scrutinized is revenue, it’s imperative to also look at how a company is managed and if its structure and operating procedures stimulate profitability.

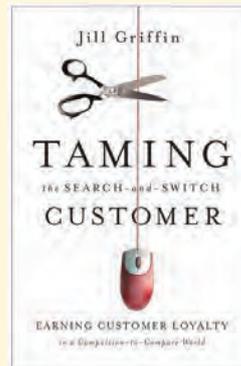
In *Chasing the Rabbit*, Steven J. Spear argues that business leaders

need to realize that discovery and self-improvement are the most valuable assets a business can have — attentiveness to quickly solving and circumventing problems, sharing learned

knowledge and instilling effective management operations are paramount importance for helping companies to not just stay afloat, but to excel. Having recognized Toyota as a “rabbit” organization that steadily increases its lead in the competitive automotive industry, Spear spent many months working within the company, learning its processes and dissecting its success into an understandable format that other companies can implement in order to achieve a “high-velocity” position. *Chasing the Rabbit* relays these lessons from Toyota, as well as case examples of many other organizations such as the U.S. Navy, NASA, Alcoa, Intel, Intuit, Institute for Healthcare Improvement, and others.

Steven J. Spear. McGraw-Hill.

Taming the Search-and-Switch Customer



Jill Griffin has spent her career consulting with businesses on how to get and keep loyal customers. Her book, *Taming the Search-and-Switch Customer* offers practical advice for winning customer loyalty. Griffin takes a close look at why customers are compelled to search for new options and then switch them. She also

examines the new rules for building good brand perception, explains how to build trust, and how to be and stay different in the eyes of customers. The book also includes the buyer’s “worth-it test” — a short list of questions that will help companies figure out how their customer perceives them and whether they are, in fact, considered more “worth it” than their competitors.

In order to ace the test, Griffin suggests companies consider the following: make sure front-line staff is all “worth-it” makers; routinely deliver the unexpected; and earn favourable product ratings and reviews and then showcase them.

Jill Griffin. Jossey-Bass.

"For many businesses, SYSPRO ERP works right out of the box, but for companies that are actively involved in refining their business processes, SYSPRO's focus on flexibility and integration can open up a world of opportunity."

Robert Cotran, VP Technology, Densigraphix

Densigraphix & SYSPRO: A World of Opportunity

In today's increasingly rapid and competitive business environment the ability to communicate and share relevant information across the entire enterprise, as well as up and down the supply chain, is critical to address the demands of an increasingly demanding marketplace. To achieve this goal requires an ERP system with a flexible open-architecture. Densigraphix Kopi Inc. is one such company that is leveraging the open architecture of the SYSPRO ERP system to refine and extend their business processes to sharpen their competitive edge.

Densigraphix was founded in 1979, in Montreal, Quebec, by Camille Cotran, who perceived an opportunity to provide copier dealers with a lower cost alternative to OEM electrostatic copy paper. As the company's dealer base migrated to selling and servicing the first generation of Japanese plain paper copiers, Densigraphix introduced generic toner, to lower the cost per copy and increase the dealers' profits. In 1989, Densigraphix saw the potential of the fledgling laser cartridge remanufacturing business. Ten years later, Densigraphix acquired Sel-Drum Corporation, a company which targeted the same customer base as Densigraphix, but focused on replacement copier parts such as drums, blades and fuser rollers. With the acquisition, Densigraphix has given its customers the ability to one-stop shop for both toners and copier parts.

In 2000, Densigraphix implemented SYSPRO Enterprise Resource Planning (ERP) software. Since the introduction of SYSPRO 6.0, Microsoft®.NET component architecture and XML standards have been leveraged to deliver "e.net solutions," an open framework that provides users with a standardized method for directly accessing SYSPRO's business functionality.

SYSPRO e.net solutions is predicated on "business objects"; componentized modules of code that can be independently accessed to perform specific business functions and processes. Business objects also allow external applications to interact and communicate with SYSPRO, using functionalities such as Web Services.

Through the use of business objects, in-house applications can be created to enhance, simplify and extend SYSPRO functionality onto websites, into warehouses, and onto the shop floor. Since business objects use the core system's security, third party developers are relieved of the burden of duplicating SYSPRO security settings in their external applications.

Furthermore, since business objects are separate from SYSPRO source code, external applications will continue to work after upgrades to future versions of SYSPRO.

Enter Robert Cotran, Densigraphix' VP Technology, a man with a talent for "object-oriented" programming. Cotran has used SYSPRO's business objects for a variety of tasks, allowing Densigraphix and its supply chain partners to streamline business processes across the Internet, and facilitating the construction of interfaces that simplify and extend SYSPRO's functionalities.

Since 2001, Densigraphix' B2B eCommerce website has allowed supply chain partners to place orders, view their order history, and track the status of their orders online. "Our B2B website has greatly improved the quality and accuracy of business information at our customers' disposal," says Cotran. "In turn, that allows us to improve delivery times, and provide our customers with a higher level of service."

B2B integration facilitates the transformation and exchange of information between SYSPRO ERP and other applications, including legacy systems. Densigraphix' partners and customers can order, query and update their information, regardless of the conversion requirements and data formats used. "Our Internet applications write orders to SYSPRO using business objects," says Cotran. "That enables us to quickly establish and manage Internet relationships with other organizations. It also makes it possible for us to automate document interchange effortlessly."

While eCommerce provides an important competitive edge, for Cotran, it's only the tip of the business object iceberg. While the vast majority of SYSPRO users run it "straight out of the box," Densigraphix has created some 50 company-specific software applications. "We refer to a group of them as our suite of Predictive Operations Management (POM) interfaces," says Cotran. "It's the use of business objects in SYSPRO that has allowed us to do this."

Utilizing business objects and SYSPRO, Densigraphix has taken advantage of an open architecture to optimize its IT investment. Says Cotran: "For many businesses, SYSPRO ERP works right out of the box, but for companies that are actively involved in refining their business processes, SYSPRO's focus on flexibility and integration can open up a world of opportunity."

For more information on Densigraphix, please visit their website, www.densi.com.

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News and views

New and noteworthy information you can use

Four in 10 Canadian companies planning reductions and revisions

As the global financial crisis takes a tighter grip on the economy, some Canadian employers are bracing themselves for the looming economic slump. More than four in 10 companies have either made or planned layoffs or reductions (44 per cent) and revised merit payments (42 per cent) over the next year. According to the survey conducted in November 2008 by Watson Wyatt, a global consulting firm, employers are also increasing employee communications and halting new staffing. The survey also indicates that while many companies are considering changes, less than 20 per cent consider such changes to be significant.

The survey of 138 Canadian-based companies from various industry sectors found that 42 per cent are revisiting merit and other increase budgets for 2009. These organizations anticipate that merit budgets for 2009 will decrease by an average of 39 per cent (from 3.3 per cent to 2 per cent). From an overall perspective, the net effect of these anticipated reductions will result in a revised merit budget of 2.9 per cent which represents a significant decrease from previous projections of 3.5 per cent. The revisions to merit and other salary increases are more prevalent among companies within the financial, professional business services, and manufacturing sectors. Additionally, 41 per cent of respondents have already stopped or will freeze new hires while nearly one third (31 per cent) confirmed they have already made or will be going through organizational restructuring.

“Although there is a high level of uncertainty in the market, employers are cautiously moving forward to deal with the challenges of the economic downturn,” says Liz Wright, compensation practice leader, central Canada at Watson Wyatt Worldwide. “However, while measures such as workforce reduction and cost controls may be necessary in some instances, companies should maintain a balanced approach that includes actions such as enhanced employee communications to retain critical talent and boost employee morale and confidence.”



Additional survey findings in other HR-related areas suggests the majority of companies surveyed are keeping the status quo and are not planning significant changes over the next 12 months.



Management

Editorial Think Tank

Anthony Atkinson, CMA, FCMA
Professor, University of
Waterloo, Waterloo, ON

Pierre-Jean Dion, CMA, FCMA, M.Sc.
Executive Consultant and
Associate, Optima Management
Inc. and President of the CMA
Observatory of Management
Accounting Practices,
Montréal, QC

Clare Isman, CMA, FCMA
Chair, Saskatchewan Public
Service Commission, Regina, SK

Lynda Kitamura, CMA
Vice-President, Finance &
Administration, and CFO,
Hewlett Packard (Canada) Co.,
Mississauga, ON

Glen LeBlanc, CMA, FCMA
Senior Vice-President and CFO,
Aliant Inc., Halifax, NS

John Mould, CMA, FCMA
Ombudsman, HSBC Bank Canada,
Vancouver, BC

Global accountancy leaders address credit crisis

Survey results from the IFAC's (International Federation of Accountants) 2008 Global Leadership Survey suggests the credit crisis is bringing attention to the value of professional accountants and the services they provide. Chief executives and presidents of 110 accountancy organizations worldwide responded to the survey. The majority of these organizations have been actively engaged, like IFAC, in identifying and executing appropriate responses to the crisis, supporting their members in understanding applicable international standards, and working with regulators, business groups and others to find solutions. Many of these initiatives are featured on IFAC's website www.ifac.org/financial-crisis/

"It is now up to the profession to continue to meet the expectations of those that depend on our work and to contribute to rebuilding confidence in financial markets," Ian Ball, chief executive, IFAC, says.

Leaders of accountancy organizations reported an increased trend in the need for services that are related in some way to the crisis. For example, in the coming year, they expect their members in public practice to be more involved in corporate recovery and insolvency services, assurance services (other than audit), as well as risk and compliance related work. Members employed in business and industry are also expected to be more involved in risk management, as well as in the areas of corporate social responsibility and sustainability, internal control, and governance and compliance work.



Correction notice

On page 3 of the February 2009 issue of *CMA Management*, Mr. Anthony A. Atkinson, FCMA, was wrongfully referred to as Mr. Anthony A. Atkins, FCMA. *CMA Management* regrets the error.



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Respondents believe that the most important issues for the accountancy profession in the coming year are:

- ¹ Addressing the needs of small and medium enterprises (SMEs) and small and medium practices (SMPs);
- ¹ Meeting expectations to identify and prevent fraud;
- ¹ Dealing with the changing regulatory landscape; and
- ¹ Transitioning to International Standards on Auditing.

They also believe it is increasingly important to address the transition to International Financial Reporting Standards, auditor liability issues, the use of new technologies like XBRL, and corporate social responsibility issues.

Recently-appointed IFAC president, Robert Bunting, has indicated that addressing the needs of SMPs and SMEs will be a priority for the IFAC over the next two years.

“The survey confirms that meeting the needs of SMPs and SMEs is a global concern and a global goal. These entities are among those likely to suffer significantly from the current financial crisis yet they are among the least at fault. We must look for ways to mitigate the effect of the crisis on SMPs and SMEs,” he says.

Other survey results point to an increase in the attractiveness of the profession to students. According to survey respondents, the factors positively influencing students are the career options available and earning potential. However, leaders of accountancy institutes indicated that the two factors having the most negative impact on the attractiveness of the profession are work-life balance and legal liability. Most respondents indicated that they have initiatives in place to address these issues.

We welcome your comments and article ideas.

Please write to the Editor,

CMA Canada
Mississauga Executive Centre
One Robert Speck Parkway, Suite 1400
Mississauga, Ontario, Canada L4Z 3M3

Fax: (905) 949-0888
email: acivichino@cma-canada.org

Expanding role of internal audit increases need for specialty skills

Internal auditors face new opportunities and a growing skills gap as management increasingly looks to them for business improvement recommendations and coverage of a broader range of strategic and operational risks, according to the Ernst & Young 2008 Global Internal Audit Survey.

“Difficult economic conditions and heightened shareholder expectations have put pressure on executive management and audit committees to improve risk management and deliver greater value,” Neil Aaron, global leader for internal audit at Ernst & Young, says. “As a result, internal audit’s role is clearly evolving and becoming more consultative. Regulatory compliance continues to be important, but management now expects performance improvement recommendations and insights into emerging risks, in addition to coverage of a much broader range of risks.”

The survey of 348 internal audit executives in 35 countries shows a need for greater focus on operational risks over the next two years, with 75 per cent of respondents citing focus on IT, 61 per cent on mergers and acquisitions, 53 per cent on major capital programs, 45 per cent on performance improvement, 44 per cent on information security, and 39 per cent on fraud. Yet, only 69 per cent of respondents are at or above 90 per cent of budgeted headcount, with 64 per cent indicating that recruiting and retaining subject matter specialists in these areas is a challenge.

The survey finds that internal audit’s traditional competencies don’t fully meet the needs of today’s organizations. This lack of resources with relevant experience and knowledge hinders the ability to conduct an effective risk assessment. Only 17 per cent of respondents rated their risk assessment performance as “very competent.”

The full report is available at www.ey.com.

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Like a crossover vehicle, hybrid-communication training addresses multi-faceted needs

A multi-cultural workforce requires a multi-pronged approach to communication-skills training.

By Teresa McGill

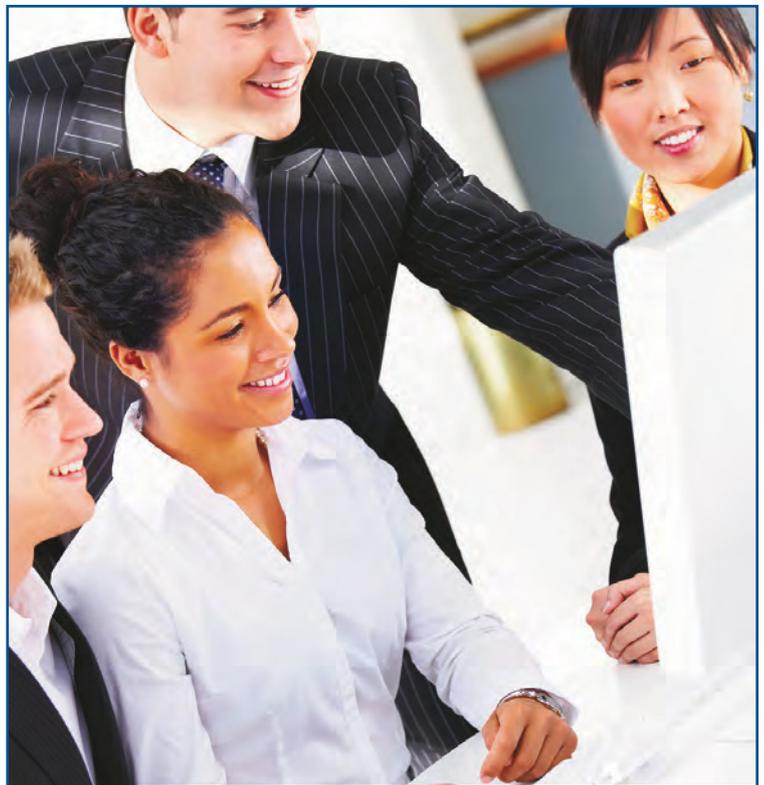
Managers working with internationally-trained professionals (ITPs) frequently face situations where no single type of training seems quite right. The solution may be three-in-one hybrid training that intertwines soft-skills strategies with English language skills and intercultural awareness.

Recently, an engineering project manager described a meeting in which her newest staff member “Tam,” a senior engineer, and his colleagues were exploring solutions to a difficult production problem. While most members of the team had become animated and enthusiastically debated various options, Tam was silent and withdrawn; characteristics he had not previously exhibited.

The engineering project manager explained that she had hired Tam, a relative newcomer to Canada, partly because of his reputation as the person a company could call on to solve complex technical problems. In addition, Tam’s first Canadian employer had commended his ability to initiate innovative ideas, his warm sense of humor and deftness at defusing tension. Within weeks of hiring Tam, he had successfully demonstrated these attributes; however, within time, Tam’s contributions to the team started to diminish.

After probing the issues with Tam, it was discovered that he had actually encountered a similar production issue at his previous job, and was eager to recommend a solution. However, he was simply too overwhelmed by the fast-paced conversation of this particular meeting to contribute his suggestions.

As Tam elaborated on the details of his communication struggle, it became apparent that the issues were threefold. First, he needed guidance on



tactical soft skills for interacting in meetings — ways to interrupt, ask for clarification and verify understanding. Second, Tam required core language skills to increase his comprehension, fluency and accuracy, enabling him to enter the fray of a lively discussion with greater confidence and ease. Finally, Tam required coaching on Canadian culture to grasp the simple fact that here, unlike in China, it is not an insult to ask one’s manager for clarification. Based on our recommendations, Tam’s manager arranged appropriate training and several months later, Tam’s communication comfort level greatly improved.



Balance needed between technical and communication skills

In a workplace with increasing numbers of ITPs, many employers are discovering an imbalance between team members' highly developed technical skills and their less-advanced communication abilities. Many newcomers experience challenges in adapting to Canada's business communication environment.

As a result, many gifted ITPs are frustrated to find themselves assigned a narrow range of work duties, excluded from direct customer contact, and missing leadership and career advancement opportunities. This is a serious issue from the perspective of engagement, productivity, retention and career mobility.

Take for example, "Marjana." A competent and diligent IT professional, she had lived and worked in Canada for almost five years. But when she was designated to oversee an important project, Marjana soon found herself excluded from meetings with the clients. Her colleagues feared her abrupt speaking style would jeopardize client relations. Her company missed having its most knowledgeable person at the table; Marjana felt excluded and unappreciated, her contributions marginalized. She began to consider seeking new employment opportunities. Fortunately, her organization's training manager intervened and was able to recommend appropriate communication-skills training. A year later, Marjana has become a highly regarded team leader.

Hybrid training trumps single-pronged approach

Tam and Marjana (both pseudonyms for confidentiality) typify the many thousands of ITPs now working for Canadian companies. With high levels of formal education and valuable international experience, they are ambitious, well-paid and eager to continue learning and advancing. However, managers who want to support and encourage them in their communication-skills development are not always sure how to select appropriate training.

Soft-skills training is often the first solution that comes to mind. It's not unusual to find ITPs

sidelined in workshops on presentation skills, business writing, leadership, team communication and the like. Unfortunately, generic soft-skills courses usually miss the mark for the new Canadian audience since neither the curriculum nor the facilitator is equipped to address underlying language and culture issues. It's fine to advise a participant that active listening includes clarifying tactics, but it's also essential to reveal and rehearse the actual English phrases — grammatically correct, clearly pronounced and applied in a culturally appropriate way. For ITPs, this level of granularity is crucial.

Unfortunately, generic soft-skills courses usually miss the mark for the new Canadian audience since neither the curriculum nor the facilitator is equipped to address underlying language and culture issues.

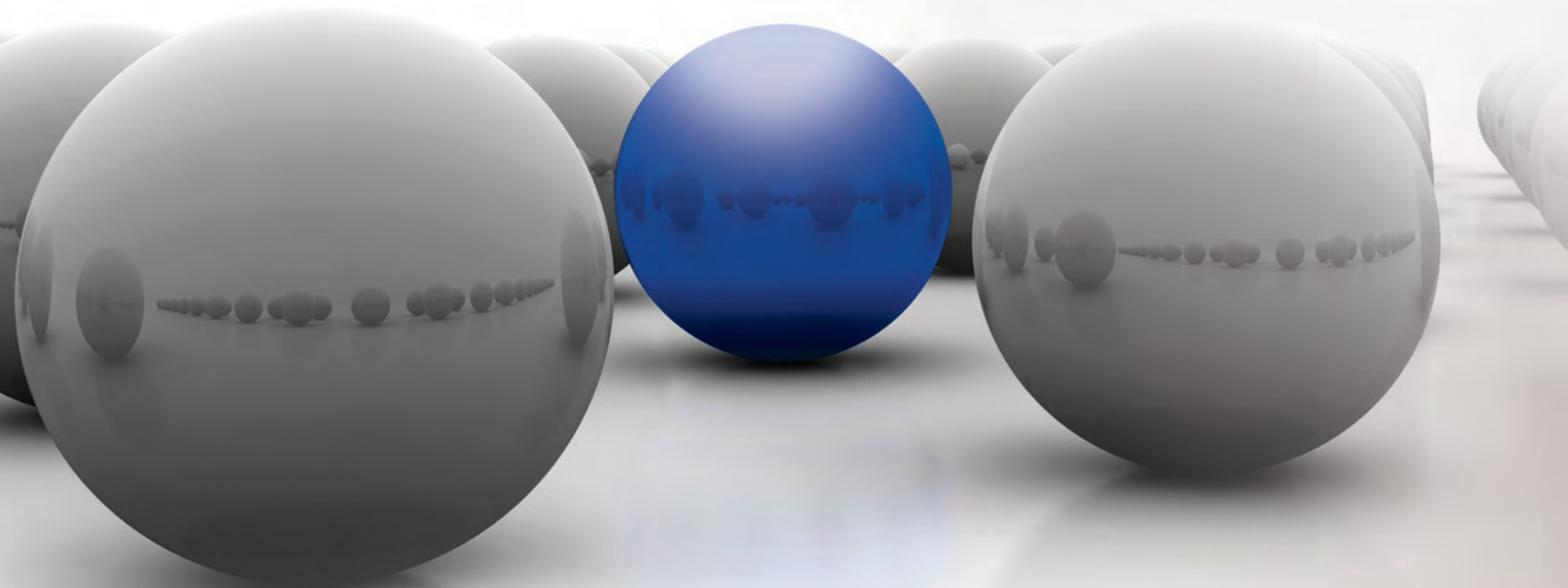
English as a Second Language (ESL) programs are another option. While core language skills (grammar, vocabulary and pronunciation) and conversational fluency are important in business, the core-language curriculum is vast, and not all of it relates to a workplace context. Moreover, most highly educated professionals have already been exposed to their fill of "traditional" English classes and are ready for something better suited to their professional status.

Intercultural communication training is a third alternative. Undoubtedly, gaining insight into the subtleties of office politics is a benefit to new Canadians, but without a complementary language component, the practical benefits of this approach are limited.

Clearly, no single approach is sufficient. Innovative communication training firms begin with an analysis of a client's needs from a business perspective — soft-skill strategies and tactics needed to navigate daily work-related interactions. In a case such as Tam's, clarification tactics were crucial; for Marjana, diplomacy and rapport-building were key.

Effective communication skills convey confidence and capability. By combining, rather than isolating the three key areas of communication training, employers who hope to attract, develop, retain and promote top talent of international origin can enable their new Canadian professionals to fully contribute to the workplace. ▀

Teresa McGill (teresa@gandy.ca) is the president of Gandy Associates.



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Driving performance enterprise planning

Continuing deregulation, advances in technology, new disclosure requirements, and wary investors, creates both challenges and demands for accurate business planning and forecasting.

By Doug Barton

For private companies, better planning is a competitive necessity, while in public companies, poor planning has a direct bearing on shareholder value.

Studies show that the markets consistently punish companies that do not accurately forecast their financial performance, even if that performance is objectively good. By contrast, companies that can consistently deliver forecasted results are rewarded with a premium in their market capitalization. Business leaders, analysts, and other business watchers have pointed out the need to manage company-wide performance more effectively. Planning is a key element of this performance management (PM) approach. Smart organizations are winning through an integrated strategy for PM. They drive enterprise performance through planning; they monitor performance through scorecarding, and understand performance through reporting and analysis.

Introducing Enterprise Planning

What is the right solution for enterprises seeking a higher level of execution? Is it budgeting and forecasting? Performance measurement? Financial reporting? Management scorecards? The fact is — taken separately — these initiatives are only partial solutions.

True enterprise planning emerges where business planning, business intelligence and business analytics intersect. The cornerstone is planning. Performance must be planned in a coordinated way that integrates the many planning, reporting, and analytical processes underway at a given time in a large enterprise.



Enterprise planning is a multi-phased discipline that combines people, process, and technology in a rich, continuous, broadly collaborative cycle. It provides useful insight into past, current, and future operating performance in time to identify opportunities and affect outcomes.

Enterprise planning means articulating what you want to achieve, and how you will achieve it — through a hierarchy of cascading plans, measures, and reports that flow from corporate objectives to tactical plans across departments, divisions, and locations. It relies on input of hundreds or thousands of people who must execute. And it stays up-to-date through real-time visibility and focus on the value-driving activities that affect performance against stated goals.

Enterprise planning generates discrete plans and budgets for every relevant employee and external partner and communicates those plans, and the actions required, to those who need to know. It provides real-time feedback, realigns plans as the situation evolves, and simultaneously ensures performance plans

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and forecasts are coordinated across functional and geographical silos, providing a consistent, enterprise-wide understanding of how to execute the game plan.

Seven steps to best-in-class performance

1. Establish the game plan: model

The first step in any enterprise planning initiative is to start at a very high level to assess and define what best-in-class performance means to your organization. This includes the metrics that define success in your markets and ways to maximize an organization's potential.

To get the full range of options, first determine what your key assumptions are: desired growth rates, market share, and productivity metrics. Once you've made these determinations, you can create a model that properly links your drivers to outcomes. It is an iterative process that can range from strategic change — such as new ideas, or technologies — to operational change—such as daily updates of performance data for rapid assessment/adjustment. This is the ideal time to explore other options — for example, what happens if you acquire or divest business lines?

2. Align the enterprise: plan

Once you have identified a strategic direction that enables competitive advantage, you need to work with the rest of the team. This means cascading targets from top to bottom across the organization and exploring/validating those goals. When you align the enterprise, you solidify a corporate plan. You can ensure individual targets properly reflect the plan and that individual actions, decisions, and processes — enterprise execution — are synchronized and rewarded.

3. Communicate, coordinate, and commit: budget

Once you have defined the targets, you are ready to make the plan operational by breaking it down into the activities, decisions, and initiatives needed to achieve your goals. In this phase, you distribute the individual plans and reach out into your organization to get bottom-up input from people who are on the front lines in every important area of the company—such as sales representatives, production managers, marketing directors, and HR executives.

Their role is to validate your model and plan by providing bottom-up contributions specific to their own areas of responsibility — what do they think they can achieve? You need to gain their commitment and ensure their plans are aligned with enterprise objectives. Individual contributors possess clearly defined objectives and targets specifically related to the strategic goals of the organization. For example, engineers understand that competitive R&D spending trends will dictate their budgets. Virtually every engineer believes they can build better products for less money than competitors.

4. Avoid surprises: monitor

After you've identified performance goals, created a game plan, and translated it into actionable plans and budgetary parameters, you need to track progress and monitor day-to-day operational performance. As part of enterprise planning, you create a set of interconnected performance indicators that make goal driven metrics available to thousands of employees across your organization. Such metrics are easily understood and clearly outline how individual decisions and actions fit into the strategic plan and

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contribute to meeting operational goals. Accountability is enhanced as well, because there's no doubt about organizational priorities — who is responsible for what and when.

5. Understand breaking news: analyze

In many organizations, this step is where enterprise planning often ends — and it shouldn't. Ideally, all of these detailed, cascading plans should be “living documents” that are regularly updated based on analysis of your current operating performance. Forecasts should be refreshed on a continuing basis, becoming rolling forecasts that give a recurring 12-18-month window into future activity. An important part of this refresh cycle is analyzing results and fine-tuning your plans and forecasts. You can change the game plan, if necessary, to achieve greater accuracy in meeting performance goals.

6. Manage the gaps: report

Naturally, there will be gaps between corporate goals and individual opinions about what can be reasonably achieved. Are the targets wrong — or do contributors need to modify their submissions? Through reporting, analysis, and planning iterations, you create detailed performance plans that support and align with the strategic goals of the organization. And you can do this in a cross-functional way — not in silos.

Once those contributions are complete, higher-level managers review the submissions. Traditionally, review cycles have never been an optimized step in the overall planning process. However, communication from the top down is the foundation of enterprise planning and when executed well, a review cycle is extremely beneficial to the process. A key reason for “review failure” has been the absence of a technology platform that integrates all plans so that as one plan changes, it automatically consolidates into the total plan-and aggregates “sideways” to all the other plans it affects.

As a result, most organizations' review cycles are dictated by aggregation cycles — batch-oriented and the periodic collection of data about business outcomes (revenue) or resource requirement (expenses or capital requests). Individual managers and supervisors must work according to a standard schedule instead of one optimized to their own business needs. Aggregations can't be performed until the last person does his or her work, which naturally causes many contributors to wait until the last minute to complete their submissions. It also drives a fixed number of review cycles — which may be too many, or too few for individual groups.

7. Realign and re-focus: re-forecast

The final step ... is also the first step. Using your analysis and reports, you can align with the changes in your business environment. You can achieve a simple, but elusive goal in planning and performance management — the rolling forecast. By supplementing-or even replacing — your annual budget with a rolling forecast, you reinforce planning as a core competency in the organization, a key management skill to be respected and honed through frequent application. In turn, you benefit from increased accuracy and the earliest possible visibility to future operating performance. It allows you to explore corrective actions where necessary, and keeps you aligned with your corporate objectives. ▀

Doug Barton, MBA, CPA, is the vice-president, product marketing, financial performance management, at Cognos, an IBM company.



The future is now: affordable strategic advantages for sale

Companies that are highly leveraged and struggling in today's tight capital markets represent a competitive edge for purchasers.

By Christopher Porter

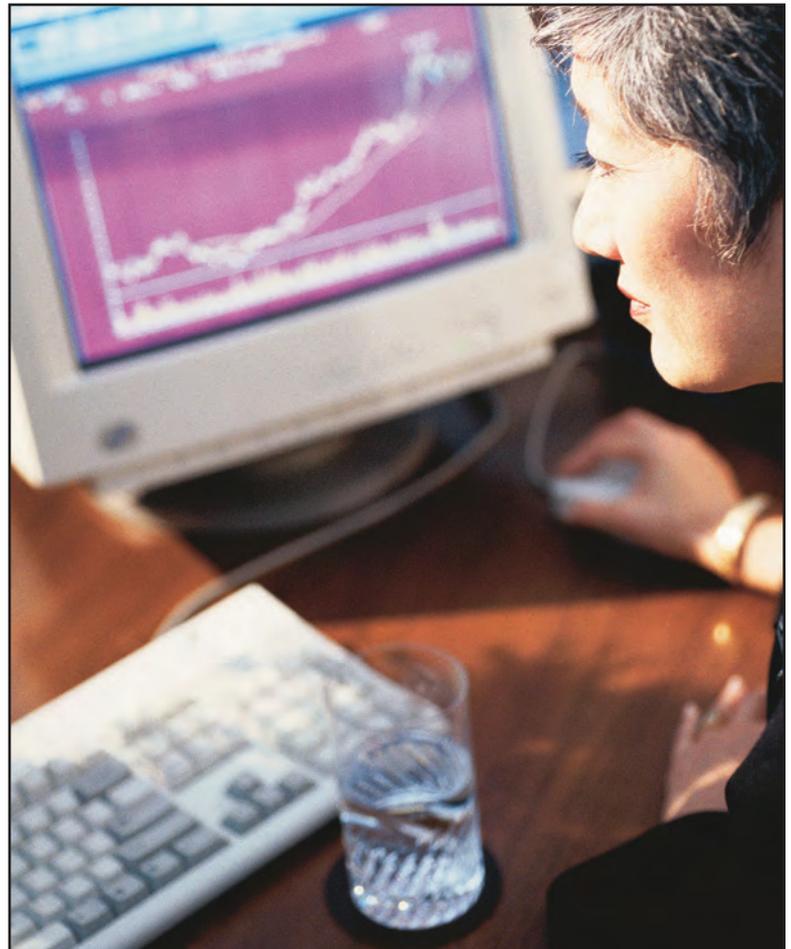
The grapevine is working overtime these days. Unpredictable stock markets and a global recession have transformed us into news junkies. We all want to know who's doing well and who's struggling.

For small and mid-size businesses with ambitious growth plans, this is a good time to stay close to that grapevine. If your organization has cash, borrowing room or unencumbered assets, it could reveal some timely opportunities to shop for strategic advantages.

When an organization is struggling to remain afloat financially, decisions must be made without delay.

Companies that are highly leveraged and struggling in today's tight capital markets represent a competitive edge for purchasers: critical mass, geographic expansion, product diversification, a long-term customer base, intellectual property, a skilled workforce, a respected brand and others.

Well capitalized small and mid-size businesses have another advantage over larger organizations in today's market — they tend to be agile, able to make timely decisions and complete deals quickly. This is necessary when acquiring a company with liquidity challenges. While purchasing such a business obviously carries risks, many of these can be managed through the appropriate transaction



structure and process. If you are looking for affordable strategic advantages, here are some suggestions to keep in mind.

Quick decision making

It's important to be aware that the acquisition process will likely be compressed and may be opportunistic. When an organization is



struggling to remain afloat financially, decisions must be made without delay. Thus, it's important to clearly define goals before initiating an acquisition search to readily determine which buying opportunity may achieve them.

It's also helpful to plug into that grapevine and find out how competitors, suppliers, customers or others in the industry are faring. If a purchaser prefers to maintain a low profile while doing so, transaction advisory professionals can do confidential inquiries on the buyer's behalf to determine whether a company may be interested in selling. This approach can also help to prevent a sale price from escalating in situations where a potential vendor becomes aware of the identity of a prospective purchaser.

Often, due diligence will also have to be conducted quickly for a purchaser to mitigate weaknesses arising from an acquisition's escalating financial challenges. But it's still essential to complete the necessary reviews. A lawyer and financial advisor experienced with mergers, acquisitions and insolvency proceedings can ensure this happens. A financial advisor can even sign a confidentiality agreement with the vendor and build a relationship to focus on the areas of the prospective acquisition that are of most interest to a buyer. This individual can meet with management, investigate financial statements, customer relationships and financing arrangements and conduct a search under the Personal Property Security Act to determine which parties have title, security or claims on assets.

Under the restrictions of a confidentiality agreement,

professionals would not be able to provide a prospective purchaser with detailed information about the vendor organization; however, a buyer could have a level of comfort regarding whether the opportunity would be worth pursuing. If the purchaser then decides to move forward, much of the due diligence would have already been completed and purchaser and vendor could focus on the most important issues such as the integration of the businesses.

In fact, effective integration is key to the success of most business acquisitions. It's vital to look at the nature of both organizations and identify where and how they need to be integrated. Some of the most common challenges relate to the workforce, customers, products and brands.

Since financially-challenged companies are often leaking cash and are unable to secure additional working capital, purchasers usually

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want to minimize assumed liabilities. A variety of transaction techniques can be used to limit and control risk. These include purchasing assets rather than shares and/or using an insolvency process to disengage liabilities from assets.

Most vendors prefer to sell shares since this generates capital gains. These have a lower effective tax rate and vendors may be able to use the lifetime \$750,000 capital gains exemption. As well, some purchasers prefer to buy shares in order to utilize tax loss carry forwards. When a company is experiencing financial difficulties, however, most buyers will opt to purchase assets in order to avoid creditor or employee claims or litigation. There are a number of ways to separate liabilities from assets. A purchaser can acquire the assets through a “vesting order” from the court as part of an insolvency proceeding, for example, which provides a buyer with the rights to assets free of liability to unsecured creditors.

When purchasing assets, a buyer must comply with the Bulk Sales Act.

When purchasing assets, a buyer must comply with the Bulk Sales Act. This legislation protects creditors when a company disposes of its assets: buildings, inventory, equipment, fixtures, etc. The legislation is intended to prevent owners from pocketing the proceeds from the disposition of these assets and leaving creditors empty handed. Compliance requires the vendor to pay creditors at closing or to demonstrate to the court that creditors will be paid. If the proceeds of the sale will not be sufficient to pay creditors, they must be paid to a receiver or a Bulk Sales Act trustee. If a purchaser completes a transaction without bulk sales compliance, the buyer may be responsible for creditor claims. Purchasing through an insolvency proceeding is a common way of dealing with the Bulk Sales Act issue.

Some vendors and purchasers also make use of the Companies’ Creditors Arrangement Act

(CCAA) in order to restructure a financially-challenged business and sell it as a going concern. By filing for protection under the Act or by issuing a Notice of Intention to make a proposal under the Bankruptcy and Insolvency Act, a company may be able to stay creditors long enough to close the transaction. A financial advisor experienced with insolvency proceedings can help the vendor operation maintain cash flow until this happens. If there is a delay in closing the deal, the purchaser can sometimes enter into a management agreement to operate the business until closing.

An insolvency proceeding can also allow a company to restructure prior to a transaction. The organization might shut down unprofitable divisions, disclaim leases, adjust employment levels, or dispose of redundant assets to make the business viable.

Standard purchase and sale agreement

While structuring a transaction appropriately can limit a purchaser’s acquisition risks, it’s also important to be realistic about the limitations of representations and warranties. In a standard purchase and sale agreement, these terms are usually extensive, specifying the rights and obligations of vendor and purchaser related to a range of issues: capitalization, financial statements, accounts payable/receivable, inventories, condition of properties, withholding taxes, undisclosed liabilities, intellectual property, contracts, litigation, insurance, employee benefit plans, and more.

Given the financial situation of a business in financial distress, however, reps and warranties would be limited. Many such businesses are sold on an “as is basis.” An experienced insolvency lawyer can help a buyer achieve a comfort level with the scope of possible representations and warranties.

Like much in business life, purchasing any company is a leap of faith. If we thought too long about these decisions, we’d probably never make them. Purchasing a struggling business, however, offers opportunities to accelerate long-term plans. One service company, for example, recently purchased the assets of a business, which included an office location and most of the sales force and employees. The purchaser was able to expand its product distribution into new markets within weeks. If that buyer had instead recruited, hired and trained a team of this size, months of intensive effort and a substantial investment would have been needed.

With defined goals, professional support and decisive decision making, you may be able to accelerate your own future plans by purchasing cost effective strategic advantages today. ■

Christopher Porter (cporter@bdo.ca), MBA, CA•CAIRP, is an associate in the transaction advisory services practice of BDO Dunwoody Ltd.



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Planning and budgeting in non-profit organizations



By Michel Piché, CMA

Unless the process is supported by well-defined policies and guidelines, clear strategic goals and operating priorities, it can become quite chaotic and confusing.

Although it's often seen as a cumbersome process by management, planning and budgeting is an essential activity for any organization. Most accountants dread this time of the year almost as much as the traditional year-end closing and audit marathon. It sets manager against manager, program against program, with everyone having to justify existing resource levels or requests for new funding.

The alignment of strategic goals and budgets for public and non-profit organizations can take many twists and turns. In participation with l'Ecole Nationale d'administration Publique, the Secretariat in Public Fund Management (SPFM) has put together "best practices" for planning and budgeting in these types of organizations. These policies incorporate organizations' formal and informal practices and advocate a goal-driven approach to budgeting, which spans the planning, development, adoption, and execution phases of the budget process. The ISPFM's work emphasizes that budgeting must have a long-range perspective and not simply be an exercise in balancing annual revenue and expenditures.

CASE STUDY

The Humanitarian Organization

A chief financial officer (CFO) started with The Humanitarian Organization in the midst of the organization's planning and budgeting cycle. He had the immediate task of issuing budget guidelines to managers in order to start the process. Although he didn't know much about the organization and its programs, he spent considerable time gathering information on strategies, operating plans, investment projects, financial policies, etc., including a detailed review of the previous year's budget document.

The Humanitarian Organization is a large aid organization that operates a multitude of programs. The organization depends on donors' contributions for its funding, but is also involved in many fee-for-service activities to help generate additional revenue. It is

overseen by a complex system of local and national governance and involves volunteers to set the organization's strategic direction, approve budgets, and monitor performance.

After reviewing documents and meeting with staff and volunteers, the CFO could not understand how the organization was able to combine all of its programs and projects into a budget document. There was no specific operating plan that linked the budget to the strategic goals, budget policies were almost non-existent, guidelines dealt mostly with accounting matters, performance indicators were nowhere to be found, and the previous year's budget document read more like a statement of intent.

The CFO realized that, although the board spent considerable time and efforts coming up with a multi-year strategic plan, this plan had little influence on the activities performed in the field. The Organization's programs had been in place for many years and continued year after year with minimal changes. Budgeting was essentially a cost review exercise with efforts spent finding new revenue to fund increasing expenses. It seemed that only a crisis could justify objective review and analysis of programs.

Regardless of the challenge, the CFO put together budget guidelines based on more than 20 years of experience. He developed basic financial and budgeting policies "on the run" to provide for a more rational basis to assess ever increasing demands. These policies were focused primarily on setting expected operating outcomes, price and cost increases, and capital expenditure limits.

As the budget process moved forward, it became obvious that extensive negotiations would be required to address the managers' many "wants and needs." Despite the frequent communication with management, staff, and volunteers, the numbers that vastly exceeded the organization's funding capacity. Furthermore, there was minimal alignment of the budget requests and the organization's strategic goals.

The CFO quickly realized that his most pressing challenge was to find a way to impose order in the

process while being respectful of the humanitarian culture of the organization.

After months of intense negotiations, the CFO thought that he had achieved an acceptable balanced budget with appropriate capital spending. The board’s review meeting was fast approaching and a final budget document had to be completed and distributed. Unfortunately, despite the apparent consensus reached with managers, change requests that reflected latest economic conditions or additional programs’ needs kept arriving.

In order to meet the board’s deadline, the CFO had to make last minute arbitrary decisions, some of which were not well accepted. Discussions with managers and volunteers continued right up to the morning of the Board of Directors meeting.

The budget document was finalized within hours of the board meeting. It was a balanced budget with acceptable capital expenditures, but lacked specific operation’s targets and had minimal alignment with the Organization’s strategic goals. Although there was a separate operating plan presented to the board, it was generic and could not be linked to the financial numbers.

The Board of Directors did approve the budget document but not without concerns. Board members wanted to understand how resources allocated to the various programs related to the strategic goals. They also wanted to see key operating targets and performance indicators that would show whether the Organization was using its resources effectively and efficiently.

After this humbling experience, the CFO summarized his assessment of the planning and budgeting process. He noted the following:

1. There were few planning and budgeting policies, rules had to be made on the run.
2. Budgeting was bottom-up without clear focus, based on local wishes.
3. National priorities were neither well understood nor communicated by the regions, and mostly viewed as a hindrance.
4. There was no overall attempt to align operating priorities and strategic goals with resources.
5. There was absence of relevant operating targets and performance indicators.
6. The operating plan and financial budget were prepared simultaneously creating confusion with managers.
7. The final budget document presented to the board contained mostly financial data with very little strategic, operational, or risk assessment information.

The alignment of strategic goals and budgets for public and non-profit organizations can take many twists and turns.

The CFO proceeded to look for a plan and budget model that would provide a more effective and efficient process. His research brought him into contact with the Secretariat in Public Fund Management, where he was able to learn about “best practices” in planning and budgeting.

Figure 1. Annual Planning and budget cycle

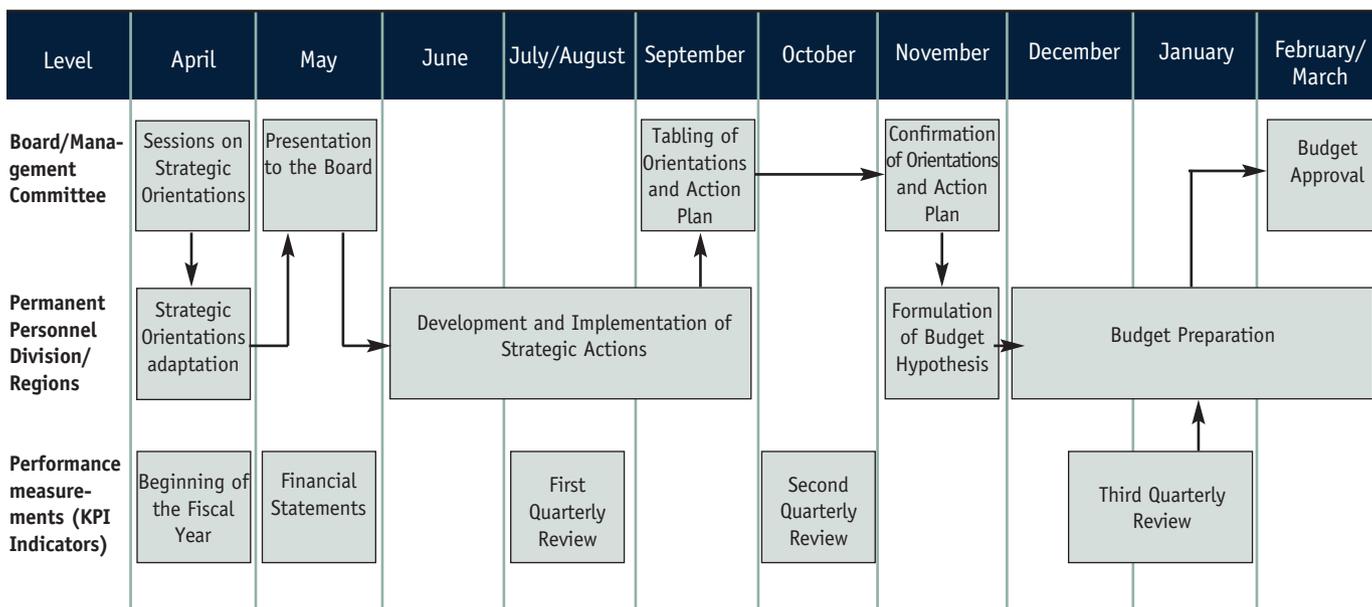


Figure 2. Management and financial policies

FINANCIAL PLANNING POLICIES	REVENUES POLICIES	EXPENDITURE POLICIES
<ul style="list-style-type: none"> 1. Strategic and financial long-range planning. 2. Policies validation and investment projects. 3. Structurally balanced budget. 4. Asset inventory, their valuation, and sustainability. 	<ul style="list-style-type: none"> 5. Revenue diversification. 6. Fees and charges. 7. Use of one-time revenues. 8. Use of unpredictable revenues. 	<ul style="list-style-type: none"> 9. Reserve or stabilisation accounts and preparedness in case of disaster. 10. Operating / capital expenditure accountability.
BEST IMPLEMENTATION PROCESS		
<ul style="list-style-type: none"> 1 Strategic planning process (forward looking). 1 Efficient internal control, audit committee and risk management. 1 Performance management and evaluation for decision making (performance indicators). 1 Value management (VM). 		
BENEFITS		
<ul style="list-style-type: none"> 1 Financial and budget management oversight. 1 Efficient use of revenues. 	<ul style="list-style-type: none"> 1 Improved program management support and resources allocation. 1 Better infrastructures. 	<ul style="list-style-type: none"> 1 Enhance techniques and provide clear and relevant information about effective strategies. 1 Greater transparency and citizen involvement.

Secretariat in Public Fund Management (SPFM)

Founded in 2005, the SPFM is a non-profit organization whose main purpose is the advancement, promotion and implementation of best management practices in public and non-profit organizations. The SPFM works closely with the Government Finance Officers Association (GFOA) in Canada and the United States to develop practical models that can help organizations manage and monitor the use of public/donor funds.

Having gone through a chaotic planning and budgeting cycle, the CFO recognized the importance of formalized financial and budget policies and turned to the SPFM for help.

Best practices

An annual budget cycle should include a broad scope of planning and decision making based on four key principles:

- 1 Establish broad goals to guide the organizations decision making.
- 1 Develop approaches to achieve these goals.
- 1 Develop a budget consistent with the approaches to achieve the goals.
- 1 Evaluate performance and make adjustments.

A good budget process should:

- 1 Incorporate a long-term perspective.
- 1 Establish linkages to broad organizational goals.
- 1 Focus budget decisions on results and outcomes (budgeting for outcomes).
- 1 Involve and promote effective communication with stakeholders.
- 1 Provide incentives to the organization’s management and employees.

As per the SPFM, the budget process must help decision makers make informed choices about the selection of programs and services and the allocation of resources.

The four principles are mapped into an annual planning and budgeting cycle that supports the preparation of a comprehensive budget document covering critical financial and budget policies. An example of the model is presented in Figure 1.

Financial and budget policies

Having gone through a chaotic planning and budgeting cycle, the CFO recognized the importance of formalized financial and budget policies and turned to the SPFM for help.

Through its research, the SPFM developed financial and budget policies based upon principles recommended by the National Advisory Council on State and Local Budgeting (NACSLB) and the GFOA.

The SPFM key financial and budget policies are summarized in Figure 2. They are considered fundamental to the planning and budgeting process of public and non-profit organizations.

The SPFM financial and budget policies are categorized in three groups:

Planning policies

Financial planning policies help organizations establish a more comprehensive long-term view and create a vision towards a sustainable future. They comprise:

1. Long-range strategic and financial planning.
2. Validation and investment projects.
3. Structurally balanced budget.
4. Asset inventory (and management), their valuation, deferred maintenance and sustainability.

Revenue policies

Understanding the revenue stream is essential to sensible planning. Most of the following revenue policies seek stability to avoid potential service disruptions caused by revenue shortfalls. The organization needs to develop policies focusing on revenue diversification, fees and charges, use of one-time revenue, and use of unpredictable revenue.

5. Revenue diversification.
6. Fees and charges.
7. Use of one-time and unpredictable revenue.

Expenditure policies

The expenditures of public and non-profit organizations reflect their ongoing service commitment. Strategic expenditure planning and accountability helps ensure fiscal stability. It is recommended that organizations adopt debt capacity, issuance and management, reserve or stabilization accounts, and operating/capital expenditure accountability policies.

8. Debt capacity, issuance, and management.
9. Reserve or stabilization accounts.
10. Operating/Capital expenditure accountability.

The financial and budget policies listed above are supported by a comprehensive guide developed by the ISPFM, which provides details on their use. This guide can be adapted to every organization following an initial assessment of the entity's planning and budgeting process. The ISPFM guide is a work in progress that continues to be updated based on development from various groups, including the GFOA.

The implementation of the ten ISPFM recommended financial and budget policies will help the organization:

1. Improve its financial management process.
1. Reassure stakeholders about the administrative and organizational planning.
1. Make the most efficient use of resources in achieving long-term strategic and financial goals.

The use of the recommended financial and budget policies will encourage the development of organizational goals and plans to achieve these goals, and the allocation of resources through a budget process that is consistent with such goals, policies, and plans. Given the evolving nature of

good management, budgeting and finance, these practices are not intended as mandatory prescriptions for the organization. Rather, they are practices that provide a milestone for the organization to make improvements to its financial and budget processes. Implementation of these practices is expected to be an incremental process that can take a number of years.

After gaining a good understanding of the concepts and application of these best practices, the CFO began to apply them within The Humanitarian Organization. He soon discovered that it was a much more difficult task than he had initially expected. Board members and staff could not understand why all this work was necessary and why planning and budgeting had to be an ongoing process. There were also some internal struggles to understand the meaning of the ten financial budget policies and subtle resistance to the need for increased transparency and accountability.

As per the SPFM, the budget process must help decision makers make informed choices about the selection of programs and services and the allocation of resources.

It became clear that these policies would have a considerable impact on the Organization's planning and budgeting practices, but also in many other aspects of its financial and program management. Most importantly, the board and senior management had to be convinced to adopt these policies as part of their ongoing governance role.

The CFO spent considerable time selling these "best practices" to board members all the way down to operations' managers (including accounting staff). It took many years of hard work, but in the end, the CFO was able to develop a planning and budgeting process which provided alignment between the organization's strategic goals and operational priorities, enabled effective allocation of capital and program investment resources, and, provided clear performance measurement indicators. More importantly, it presented key stakeholders with an objective view of the organization's planning and budgeting process. ²

Michel Piché (mpiche2@netscape.net), CMA, CIA, M.P.A., is a finance and corporate services executive with 30 years' experience in public and private organizations. He spent the last 12 years of his career as CFO in diverse sectors including: an international non-profit organization, global mining services group, and telecommunications service provider.

MANAGING CUSTOMER VALUE

SOME CUSTOMERS ARE MORE PROFITABLE THAN OTHERS. CONVERSELY, SOME ARE DOWNRIGHT UNPROFITABLE. KNOWING “WHICH IS WHICH” IS THE ALL-IMPORTANT QUESTION.

BY MARC J. EPSTEIN, MICHAEL FRIEDL AND KRISTI YUTHAS

What do companies do once they have identified the profitable and unprofitable customers? How do they attract and retain the profitable ones? Should they “fire” the unprofitable ones? Or are there ways to tweak product or service offerings to improve profitability across the board?

The AICPA, CMA Canada and CIMA shed some light on this topic in a published Management Accounting Guideline (MAG)[™], “Managing Customer Value,” which examines new tools and techniques for measuring and managing customer profitability, retention, and lifetime value.

A large and growing body of evidence indicates that, most companies have great customer diversity, with some customers being highly profitable to the company and others being enormously unprofitable. Recognizing differences in customer profitability is critical to a firm’s ability to derive value from its customer investments. Despite enormous variations in profitability, many companies continue unprofitable relationships with customers, often providing them with pricing and service levels identical to those received by the most profitable ones. Why? In most cases, companies simply do not know who the unprofitable customers are. As such, they are unable to develop strategies to direct marketing or manage costs accordingly.

Swedish automotive giant Volvo has discovered the value of customer profitability information. For years, Volvo used a sophisticated method for measuring customer satisfaction for its customers in Sweden. Using this data, Volvo has built an extensive database that allows the company to examine relationships between products and services provided and

dimensions of customer satisfaction. As a result of a recent study, Volvo was able to match customer profits with other information in the database, allowing the company to use the satisfaction database to predict the future profitability of its customers (Johnson and Gustafssen, 2000).

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Companies don’t necessarily need a state-of-the-art database or analytics technology to improve customer profitability. Rather, they can follow a comprehensive approach for measuring and managing customer value called the “Customer Value Management Cycle,” which is illustrated in Exhibit 1. It is designed to work in a cyclical manner, allowing companies just beginning to measure customer value to gain insights that can help them enhance and sustain effective strategies. The Customer Value Management Cycle presents a comprehensive model for measuring and managing customer value — it has five recurring steps.



1. Manage customer segmentation. Customer segmentation refers to the process of dividing customers into groups for decision-making purposes. Companies naturally segment customers in order to better serve their needs. It is also important to note that how the company segments its customers can have an important impact on company profitability as well. Segments are often determined on the basis of customer similarities, such as personal characteristics, preferences, or behaviors. Ideally, segments should correlate to behaviors that drive customer profitability.

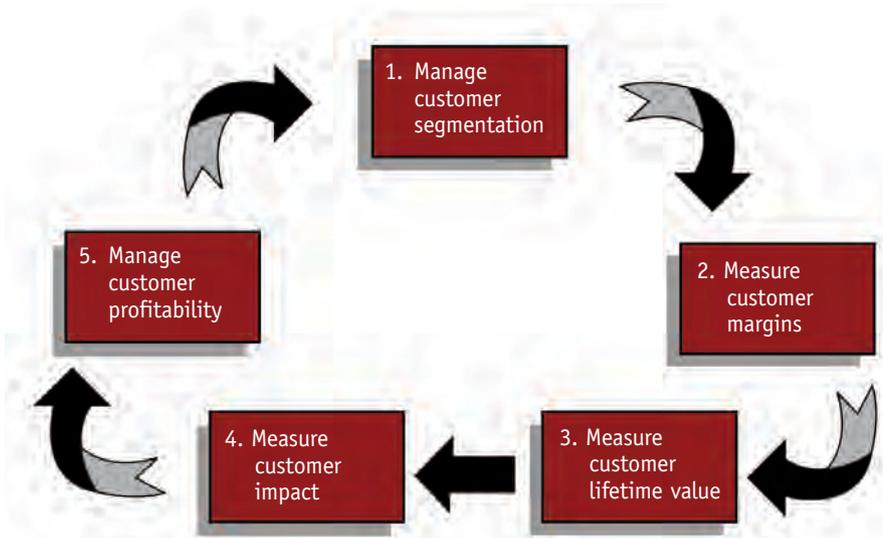
Segmentation allows a company to provide differential advertising or value propositions to different customer groups. Segments are continually redefined as the process repeats and customer understanding is refined. For many companies, segments support marketing activity; for example, customers can be grouped based on marketing-related

characteristics such as expected responses to advertisements or expected purchasing behavior. As firms move toward rigorous measurement and analysis of customer profitability, they may refine segments, or create new segmentation structures.

For example, a cleaning service company may have thousands of similar customers that could be divided into residential and corporate customer segments. It could further analyze subsegments such as size of space being cleaned, frequency of cleaning, and the industries of corporate customers. This analysis can lead to a better understanding of both customer needs and profitability and relevant managerial actions to improve success.

It is also important to include potential customers into the segmentation strategy. As companies make decisions about products and marketing strategies, they focus not only on

Exhibit 1: The Customer Value Management Cycle



markets they currently serve, but also on markets they want to serve. Including potential future customers allows a company to predict how well the company can meet the needs of these customers, and how they can be managed most profitably over the long-term.

2. Measure customer margins. Although almost all companies have processes for assessing the profitability of their products, most are far behind in assessing the profitability of their customers. Nonetheless, understanding the profitability of individual segments and customers is critical to corporate profitability.

Some customers are highly profitable, some are moderately profitable, and some are unprofitable. Many people believe that the 80-20 rule can be applied to customers, which suggests that 20 per cent of the customers are responsible for 80 per cent of the profits. However, results for many companies have been far more extreme.

For example, at Toronto-based Royal Bank, 17 per cent of customers account for 93 per cent of the bank's profits. All of the remaining customers provide only small levels of profit or generate losses for the company. So, rather than the 80-20 rule, some have suggested that 20 per cent of the customers are generating 150 per cent of the profits, with the remaining customers adding little or generating losses that draw profits back down to 100 per cent.

Clearly, to enhance value from its customer base, a company must develop the capacity to measure the profitability of its customers so that it can develop appropriate strategies for effective management. At a minimum, companies should measure revenue and gross profit by each customer segment.

However, allocating sales, marketing and customer service costs brings this analysis to the next level. Selling costs in many organizations vary significantly between customers and

segments. This disparity could be remedied by simple changes in the sales compensation plan that rewards profitable deals more highly than less.

Kemps LLC, a large full-line dairy headquartered in Minneapolis, found that one of its customers regularly ordered small quantities and required just-in-time delivery. Other customers regularly over-ordered and returned products. The costs to serve these customers proved higher, and the profits they provided were lower than those of comparable customers (Kaplan and Anderson, 2004).

In order to be effective, each organization should look at the highest cost line items and determine whether there is reasonable basis under which to allocate the costs to customers or segments.

3. Measure customer lifetime value. "Customer lifetime value" (CLV) introduces a new dimension to understanding the value a customer provides by enhancing margin-based profitability calculations, which focus on the profits already realized as a result of customer purchases. CLV takes a very different approach. It treats customers as valuable corporate assets. Like other assets, customers produce income flows that are realized in the current period. In addition, these assets can be expected to produce additional income to the company in future periods.

The lifetime value of the customer reflects the present value of all expected future flows associated with the customer. Companies that use CLV recognize that a customer's profitability in one period isn't necessarily predictive of profitability in other periods, since revenues and costs can vary significantly over time. Thus, CLV values customers on the basis of their expected future income-generating potential, rather than solely on their past behavior.

Typically, the customer relationship begins when the company invests to attract the customer. Over time, however, acquisition costs and other early investments in the customer relationship can be recovered. As the relationship matures, the customer's sales volume may grow and becomes more profitable. This accumulation should accelerate over time for two reasons. First, the cost to serve the customer should decrease as a percentage of revenues because the customer's knowledge of the company and its products, together with increasing trust, may lead to reductions in promotion, training, and relationship maintenance costs. Second, as the relationship matures, the customer may be more likely to respond to cross-selling or up-selling initiatives.

Netflix has been using CLV. It identifies five main components of its CLV estimate including forecasting acquisition rate, acquisition cost, retention rate, retention cost, and change in margin per customer over time. Since

online subscribers drive Netflix's revenues, the company is able to report a detailed account of subscriber information through its customer database, allowing it to predict CLV with reasonable accuracy (Gupta and Lehmann, 2005).

Thus, by expanding the notion of profitability to incorporate profits over the entire lifetime of the customer relationship, marketers have significantly enhanced their ability to effectively manage customers for enhanced profitability. Calculating CLV requires an understanding of customer retention rates in addition to purchasing patterns and costs for each segment, then discounting the values to the present. Simply put, CLV is the present value of profits over the lifetime of the customer or segment.

This analysis can significantly impact a company's view of a segment with small initial purchases, but with a long expected relationship, versus a segment with a larger initial purchase, but limited repeat potential.

AS COMPANIES MAKE DECISIONS ABOUT PRODUCTS AND MARKETING STRATEGIES, THEY FOCUS NOT ONLY ON MARKETS THEY CURRENTLY SERVE, BUT ALSO ON MARKETS THEY WANT TO SERVE.

4. Measure customer impact. The final component of value provided by the customer is customer impact. Activity-based costing and customer lifetime value have enabled companies to make great advances in understanding the expected profitability of their customers. They can provide excellent estimates of the value that each customer and segment provides to the company through normal purchasing and usage.

But these approaches often fail to capture some potentially significant sources of value customers can provide to the company. Of course, profits resulting from current or future sales to customers are the most significant source of value for most customer segments. But value can be created (or destroyed) by customers in many other ways that fall outside the reach of CLV.

Two critical sources of hidden customer value are discussed here — customer influence and customer knowledge.

Customer influence refers to the influence the customer has, either through intentional action or passive behavior, on other customers, on employees, or on other stakeholders of the firm.

Customer knowledge refers to the actionable knowledge that can be gained by the company, either through analysis of customer behavior or through direct customer input. Through their interactions with the product, with the company and with other stakeholders, customers can affect value in numerous ways, ranging from identifying small errors in technical

documentation to significantly influencing the image of the brand.

Although influence and knowledge contributions will always be difficult to define and measure, even rudimentary estimates of direction and magnitude can be valuable. To ignore such contributions is akin to assigning them a value of \$0, which is certainly incorrect, and may rob the company of the opportunity of investigating these increasingly important aspects of customer value.

Over time, companies that think creatively about a full range of sources of customer value gradually improve their understanding of these sources, and their ability to assess and measure them. Embarking on this process opens new avenues for innovation in products and methods, and generates new options for maximizing long-term customer value.

5. Manage customer profitability. This is where the proverbial rubber meets the road. All of the information derived from the measurement of customer value should be analyzed, and actionable tidbits should be derived. This goes far beyond simple reporting of which segments have been more or less profitable. Innovative segmentation and interpretation of the results can uncover areas where small improvements can yield big improvements in value. For example:

- 1 A segment where technical support costs are disproportionate could drive improved documentation.
- 1 Segments with lower expected customer life could reveal a lack of attention from the customer service team.
- 1 A segment with high revenues but low profits might indicate the need to retool the sales compensation scheme to shift incentives to increase focus on profits.

The Walt Disney Company, for example, found that its loyal customers were spending only a fraction of their vacation budget on Disney products and services. Disney responded by expanding its offerings to include hotels and other services and, as a result, greatly increased the profitability earned from many of its customers.

By measuring on the profitability of segments and managing customer relationships based on customer value, both the customer and company win. Orienting an organization around measurement and management of customer can take place immediately, or it can take many periods, implementing these strategies one step at a time, and adjusting and refining along the way. Over time a company will gain invaluable knowledge, and be able to put it to work for the mutual benefit of all stakeholders.

Because of their unique qualifications and abilities, financial managers should take the lead in translating analysis to action and creating the culture of value. ■

Mark J. Epstein, PhD, (epstein@rice.edu), is distinguished research professor of management at Jones Graduate School of Management at Rice University in Houston, Texas.

Michael Friedl, CPA, (mfriedl@crestpac.com), is the CFO of Crestwood Pacific Group in Newport Beach, California. He has served on review committees for several management accounting guidelines, and has spoken to professional groups about customer relationship management and fraud detection.

Kristi Yuthas, PhD, (kristiy@pdx.edu), is Swigert Endowed Information Systems management chair at Portland State University.

How **risky** is your **pension fund?**



By Margaret Woods and Kevin Dowd

Pensions are definitely risky, and accountants should be concerned. The stock market now views pension liabilities as a form of corporate debt. It's an accountant's worst nightmare when fluctuating pension values feed right into fluctuating firm valuations.

A recent report¹ states that, as of July 2007, the aggregate pension deficits and surpluses of FTSE (Financial Times Stock Exchange Index) 100 firms stood at a comforting £12 billion (\$21 billion) surplus under accounting standard IAS19. Does this suggest that the “pension crisis” is over? Not quite. The same report also indicates that, the aggregate position then “fluctuated wildly” over the next year and, as of mid-July 2008, stood at a deficit of £41 billion (\$72 billion). The report describes financial conditions in 2008 as “brutal” and estimates that these same companies’ pension schemes lost approximately £83 billion (\$145 billion) this year, thanks to a combination of falling equity markets and rising inflation. This problem is not unique to the UK — other countries are reporting similar problems.

Recent financial problems put financial risk management at the top of the corporate agenda. A forthcoming Management Accounting Guideline (MAG)TM — “Financial Risk Management for Management Accountants” addresses this issue and explains how firms can manage their financial risks.

Before these risks can be managed, however, they have to first be quantified, and there are a number of quantification methods available. Two of the more important are sensitivity analysis (sometimes also known as stress-testing or scenario analysis) and value-at-risk analysis (VaR). The results of such analyses can be very useful for both internal and external risk reporting purposes.

Scenario analysis

Sensitivity analysis involves postulating a “what if?” scenario and then working through its possible effects using a financial model (e.g. a spreadsheet model). In a pension’s context, a company operating a defined benefit pension scheme will be concerned about how much the present value of its future pension liabilities

might change in response to shifts in key “risk factors.” These would typically include salary growth and the discount rate, amongst others. Consequently, the present value of its pension liabilities is dependent upon the estimates for both salary forecasts and the discount rate. Given this dependence, it is important for the firm to gauge how much its pension liabilities might change in response to changes in these risk factors.

The table shows that the liability increases by approximately 12 per cent for each one per cent increase in salary growth. The table also shows that the pension liability falls by approximately the same amount in the face of each one per cent increase in the discount rate. These figures indicate that the value of the pension fund is very sensitive to changes in these key factors and that the pension fund is very risky.

A real-world instance, and an example of good practice in this area, is found in the 2007 annual report for Centrica. The report not only discloses the key assumptions on which the pension valuations are based, but also discloses the impact of changes to the assumptions. These assumptions relate to the rate of increase of salary, the rate of increase of pensions currently payable, the discount rate, the inflation rate and

Present value of pension liability

	Discount Rate		
Salary Growth	4 per cent	5 per cent	6 per cent
3 per cent	\$100,449	\$90,000	\$81,229
4 per cent	\$113,004	\$100,559	\$90,184
5 per cent	\$127,901	\$113,004	\$100,667

The table illustrates how pension liability might change under different assumptions.

male and female life expectancies. The report also focuses on the impact on the valuations of changes of plus or minus 0.25 per cent to each of the rates just stated, and changes of plus or minus one year to life expectancy. In the case of Centrica, a change of 0.25 per cent in salaries or a one year change to life expectancy leads to a 2 per cent change in scheme liabilities, an increase of 0.25 per cent in pensions payable (currently or deferred) leads to a 4 per cent change in pension liabilities, and a change of 0.25 per cent in either the discount or the inflation rate leads to a 6 per cent change in liabilities. This information provides a good picture of the scheme's exposure to different risk factors.

The longevity risk factor, how long people will live after retirement, is particularly important. It has become increasingly clear in the last few years that, longevity is not only rising rapidly, but is also very uncertain. This means that pension funds are highly exposed to longevity risk and firms with pension funds need to assess the sensitivity of their pension liabilities to changes in longevity. An example of good practice in this respect is provided by the Investment Company Institute (ICI). In 2005, the ICI reported that its pension deficit of £470 million (\$822 million) could in fact be £250 million (\$437 million) higher if the mortality assumption was adjusted to take account of known increases in longevity. When liability measurements are this sensitive, it makes sense for firms to report pension fund valuations based upon a range of variations in mortality assumptions: for example, as Centrica do, they might disclose the impact of a one year improvement or deterioration in life expectancy on the present value of their pension liabilities.

VaR analysis

Another popular approach to risk quantification is VaR analysis. The VaR can be defined as the maximum loss on a position or portfolio at a specified probability level over a specified horizon period. For example, a company may own an investment portfolio on which the risk manager estimates the VaR to be \$14 million, at a 95 per cent probability over a 10-day horizon period. This means that, if no investments are bought or sold over a 10-day period, there's a one in 20 chance of the portfolio value falling by \$14 million. And one day out of 20, the portfolio is expected to make a loss exceeding \$14 million.

VaR can be a useful tool for helping manage the complex risks involved with pension funds. An example of VaR analysis applied to pension risks is available in a recent article by Mercers.³ In their example, a company sponsors four different defined contribution pension plans with assets totalling €1.6 billion (\$2.2 billion) and

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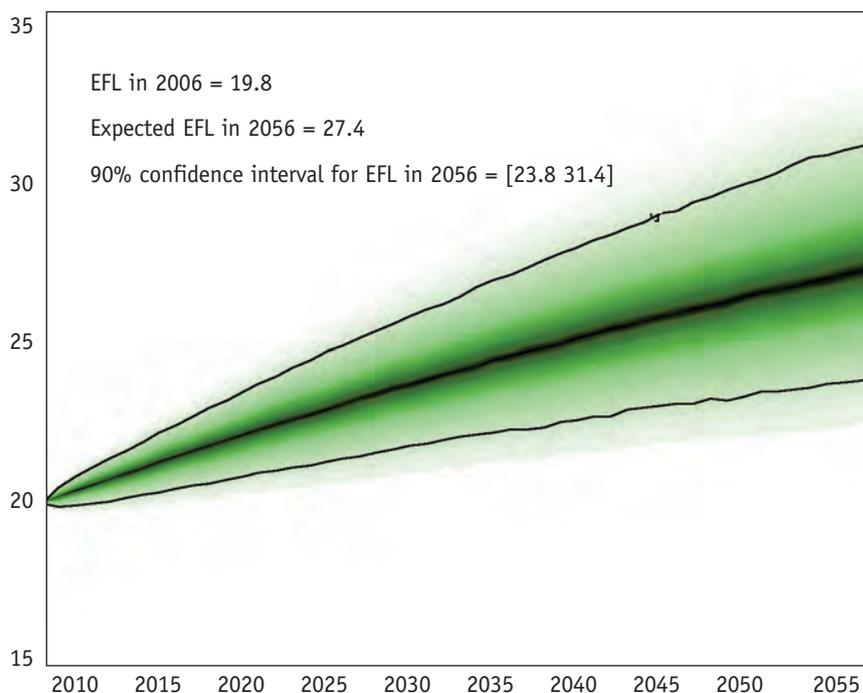
corresponding IAS19 liabilities of £1.7 billion (\$2.4 billion). The estimated VaR for the sponsoring company is about £480 million (\$671 million). The VaR is predicated on a one in 20 probability and a horizon of one year. On one year out of a possible 20, the company can expect to lose more than £480 million (\$671 million) through adverse movements in the variables that affect both its assets and liabilities. Mercers shows how VaR-type analysis can be used to determine the breakdown in its risk exposures, that is, to identify how much each risk factor contributes to the company's overall VaR. This information is very useful for determining how that risk exposure can then be managed.

Longevity fan charts

In the case of pension risks, there is also a recently developed quantification tool known as a fan chart. This is a plot that quantifies the uncertainty in a future random variable - in this case, future longevity — by showing the different ways it might evolve in the future. An example is the longevity fan chart shown below³:

The key to understanding the fan chart is the shading - the

A longevity fan chart



Source: Dowd et al. (2008)

darker the shading the more likely the outcome. The darker shading towards the middle of the chart indicates the most likely outcomes as projected by the model; outcomes become less likely as focus is moved away from the middle of the chart and the shading becomes lighter. This particular fan chart refers to the expected future lifetime of English and Welsh males aged 65 and tells us that the expected future lifetime of these males is likely to rise from 19.8 in 2006 to 27.4 (or by 38 per cent) by 2056.

The user/reader can then reasonably infer that the costs of increased longevity are likely to rise by a comparable percentage.

However, the usefulness of the fan chart does not stop there. In addition, the fan also shows two black lines superimposed over the green shading. These are the “risk bounds” which shows a sense of the uncertainty in the fan chart projections. In this particular case, the risk bounds indicate that 90 per cent probability can be attached to the actual uncertain outcome — in this case, the expected future lifetime — falling between the risk bounds. In other words: There is a 90 per cent probability that the expected future lifetime for 65-year-old males in 2056 will turn out to be between 23.8 and 31.4 years.

There are a great variety of other interest-rate derivatives, including many forms of interest-rate forwards, futures and options, which have many different uses in managing.

What is striking about this range is just how wide it is — consequently, besides indicating that the future life expectancy is likely to rise appreciably, the fan chart also indicates that future life expectancy is also very uncertain.

Managing pension fund risks

How do you manage a risky pension fund? The answer depends on the factors the fund is most exposed to. The two risk factors that come up continuously as critical in recent assessments of pension risk are interest-rate risk and longevity risk.

The management of interest-rate risk is, in principle, fairly straightforward and has been well understood for a long time.⁴ There a number of strategies available such as various forms of immunisation and asset-liability management. There is also a wide range of instruments available to implement such strategies and alter a firm’s interest-rate risk exposure. Perhaps the most useful of these are interest-rate swaps — arrangements in which two parties agree to swap future cashflows. A good example is a fixed-for-floating interest swap, in which one party agrees to pay a fixed rate and the

other agrees to pay a floating rate. Such arrangements allow a firm to change a floating rate cashflow into a fixed rate cashflow, and vice versa. There are also many forms of cross-currency swap, in which one party pays in one currency and the other in another currency. Swaps are highly flexible arrangements that can be arranged (and unwound) at low cost. There are a great variety of other interest-rate derivatives, including many forms of interest-rate forwards, futures and options, which have many different uses in managing firms’ interest-rate risk exposures.

By contrast, the management of longevity risk is very different and much more challenging. The importance of this longevity risk has only recently become apparent and the tools for managing it are still relatively few. However, the number of tools available is growing rapidly — prominent amongst these are securitizations (or pension fund buyouts), in which the company concerned pays a counterparty to take on some or all of the risks in its pension fund. The most active market for these securitizations is in the United Kingdom, where a number of buy-out funds, such as Paternoster (backed by Deutsche Bank) and Synesis Life (backed by JPMorgan) were recently set up for this purpose. The last few years have also witnessed the birth of a new market in traded mortality derivatives — including swaps and forward contracts based on underlying mortality rates. An example is the mortality forward contract (known as a q-forward) announced between JP Morgan and UK insurer Lucida in February 2008. Indeed, this “market in death” is rapidly becoming one of the liveliest markets around these days, and no doubt has a long and prosperous life ahead of it.⁵

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Kevin Dowd is professor of financial risk management at Nottingham University Business School. Margaret Woods is associate professor in accounting and finance at Nottingham University Business School.

¹ Lane, Clark and Peacock (2008, p. 2).

² Mercers (2007).

³ For more on the fan charts and their uses, see Dowd et al. (2008).

⁴ Fabozzi (2000) provides a nice overview of this field.

⁵ For more on longevity risk management, see, e.g., Blake et alia (2008).

Championing change

Dan Clarke, CMA, is a proponent of change.

By Andrea Civichino

Since joining Helly Hansen Canada Limited (HHCL) 11 years ago, Clarke has watched his career run full circle.

Clarke has worn many “hats” throughout the organization. He began his career with the company as the accountant/IT manager for six years then became the vice-president of operations in 2003. In April 2008, Clarke was promoted to president.

“When I became the vice-president of operations, it was a formalization of what I had been doing for a couple of years,” Clarke says. “I had the opportunity to learn the business from every aspect. I’ve unloaded and loaded trucks, I’ve packed boxes, and I’ve made labels in our plant. I was afforded the opportunity to indulge my nosey nature and learn this business in every aspect.”

When Clarke was interviewed for a job at HHCL, the owner was looking for an individual who could transition into a senior role in five to 10 years.

“I actually interviewed for the job that I have today 11 years ago, so as a part of my development it was

essential to learn all areas of the business,” he says. “The role as president, however, is not the destination I thought it would be. It is just the beginning of a whole new learning experience.”

HHCL is a Nova Scotia owned licensee of Helly Hansen Norway. As a manufacturer and distributor of Helly Hansen work wear clothing, the company employs more than 110 Nova Scotians in its 115,000 sq. ft. facility in the Burnside Industrial Park in Dartmouth, Nova Scotia. Since 1998, the company has been ISO 9002 registered and has worked to improve its products, service and quality control. The company’s commitment to design helped the company achieve ISO 9001-2000 registration in 2003.

Personal challenges

When Clarke joined the HHCL team he realized that he needed to make a change, both personally and professionally.

“I knew that I had a core competency around business, but I also knew that I lacked the technical skills,”



he says. “Most of it revolved around accounting and finance. Once I started to get into the CMA program further, I realized how little I knew about organizational design, human resources, strategy and the whole gamut of being a well-rounded business leader. The CMA program filled the gaps,” he adds. “Once I obtained my designation, I felt qualified to sit at a table and create policy and actually lead a session with talented people and put tangible plans in place and make them come true.”



Cover Photo: Marvin Moore

He laughs when he remembers being asked if he wanted to obtain the CMA designation in order to become a better accountant.

“That’s the last thing I wanted,” Clarke chuckles. “I wanted to become a better manager and leader and this was the designation that would give me the ammunition I needed to fight the battle. I have not forgotten that instructor because whenever I get too far into the numbers, I remember all of the wonderful things I’ve learned and it puts me in perspective on what I’m supposed to be doing.”

Adapting to change

Over the past 11 years, Clarke says the company has evolved

Through a culmination of new ideas, a stronger workforce, improved products and expansion, the company has also increased revenue from approximately \$9.5 million to \$25 million a year.

from an entrepreneurial family business to one with professional leaders and managers. Through a culmination

of new ideas, a stronger workforce, improved products and expansion, the company has also increased revenue from approximately \$9.5 million to \$25 million a year.

“We’ve gone through a number of changes and tried to expand capacity,” Clarke says. “We wanted to get into a certain market so instead of trying to spend millions of dollars over several years to develop our own product, we bought a competitor that was in trouble and we expanded through an acquisition.”

The company’s latest challenge is managing day-to-day operations through the pains of growth.

“When the company grew three years ago, I found myself doing things, like due diligence, that were new to me,” he says. “Although it was a pretty significant challenge, we never reached a point where the team couldn’t fix a problem. I try to get in the middle of things as little as possible, to be quite honest. I’m all about building a team of very competent decision makers and leaders.”

He adds that his involvement with martial arts has given him the tools to stay focused during challenging times and become a better leader.

“I am learning a lot about teaching, leadership, and the importance of giving people the opportunity to grow and develop. Plus, I strongly believe in work-life balance. It can’t always be about work.”



Clarke says HHCL provides opportunities for employees, including the opportunity to sit on committees, focus groups and town hall sessions with managers. Employees are also provided with growth opportunities within the business as many long-term staff has worked in different departments throughout their career. Personal and professional development education programs are also available.

“Many of our employees have been with us for over 20 years,” he says. “Our director of commercial sales has been with us 27 years. We try to provide all of our employees

with a voice. Employee satisfaction is one of the key measurables of our balance scorecard.”

Clarke adds that his team’s dedication to their work is a strong testament to HHCL’s commitment to worker safety.

“Since the original company’s inception in 1877 when fishermen trusted Helly Hansen to manufacture comfortable and safe raingear, our focus has always been on safety,” he says. “It’s evident in the daily routine of manufacturing garments that must meet the most stringent of standards.”

Over the years, the biggest change has been the increase in safety standards. Clarke says that a tightening of flame retardant standards and visibility safety standards opened the door to improve some of the company’s products.

“Workers’ safety is becoming a big issue and occupational health and safety issues have become stricter with liability,” he says. “By improving our products, we’ve opened up new markets to provide worker protection.”

Over the years, the biggest change has been the increase in safety standards. Clarke says that a tightening of flame retardant standards and visibility safety standards opened the door to improve some of the company’s products.

Clarke adds that the company will be launching a full line of flame retardant products this year and a selection of marine abandonment suits next year.

He admits that an increase in offshore goods within the industry has put some pressure on his marketing and sales team. While competitors are offering similar products at an attractive price point, Clarke says customers need to understand that they may be buying a product of lesser quality. In order to increase awareness and education, Clarke worked with his team of sales managers and the vice-president of sales and marketing to develop a strategic marketing tool to educate their customers more effectively on their products.

Clarke says his managerial style is all about trusting his instincts and empowering his team by giving them what they need to succeed.

“Every company has job descriptions, rules, and strategies, but when they only rely on those, that’s when they shut down capabilities. I want people to be willing to contribute to any area of a building and I never want to hear people say ‘it’s not my job.’ It’s the job of everyone in the business to make it successful no matter what.” n

Andrea Civichino is Editor-in-Chief of *CMA Management*.



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Asset-based financing: A potential solution to the credit crunch

Companies can tap their assets to generate cash flow through asset-based loans or through factoring.

By Christian Kokorian, CMA

Considering the current economic situation and the tightening of credit, central banks around the world have loosened their monetary policy with interest rate reductions to encourage banks to lend. This could not have been more apparent than on Oct. 27, 2008 in the United States, when the Federal Reserve had reduced the overnight rate to one per cent, driving it to a level seen only once before in the last half-century. Complementary to these rate cuts, large amounts of capital and liquidity have been injected in the markets around the world to stimulate the economy and prevent further economic deteriorations. Despite this influx of money, some banks (predominantly in the United States) are still hesitant in lending money to each other, which in turn, is preventing companies from having access to cash via loans, as banks want to ensure their capital is being allocated appropriately and to the right borrowers.

Companies and customers need credit at some point in time to speed up the timing of purchases (as people borrow, they are able to pay over a period of time for an item which they have purchased now). So what are the options available for good companies that need working capital to acquire assets to continue operating and growing in a time where capital is scarce? The answer could very well be asset-based financing (ABF).

ABF for working capital is a margined working capital loan based on the specific needs and nature of a company's business, as well as the strength and value of their accounts receivable and inventory, and not solely on the company's balance sheet. Generally, it offers more flexibility than traditional bank financing because given the frequent asset evaluation, banks have a more accurate idea on their short term liquid collateral than traditional lending.

ABF can be a potential solution for many companies, especially for the ones that:



Illustration: Sean O'Rourke

- 1 Are going through a period of rapid growth.
- 1 Are restricted by the limits or covenants of their current borrowing arrangements.
- 1 Have cash tied up in accounts receivable and inventory.
- 1 Are highly susceptible to cyclical or seasonal fluctuations putting increased pressure against borrowing availability.
- 1 Require additional capital to fund mergers and acquisitions.
- 1 Are undergoing restructuring.
- 1 Have strong assets to support their financing requirements.

Some advantages of ABF include:

- 1 Increased advance rates against accounts receivable and of appraised inventory value (traditional operating line is typically 75 per cent for accounts receivable and a maximum of 50 per cent for inventory).
- 1 Increased access to growth capital which reduces need of capital/equity injection by owners/shareholders.



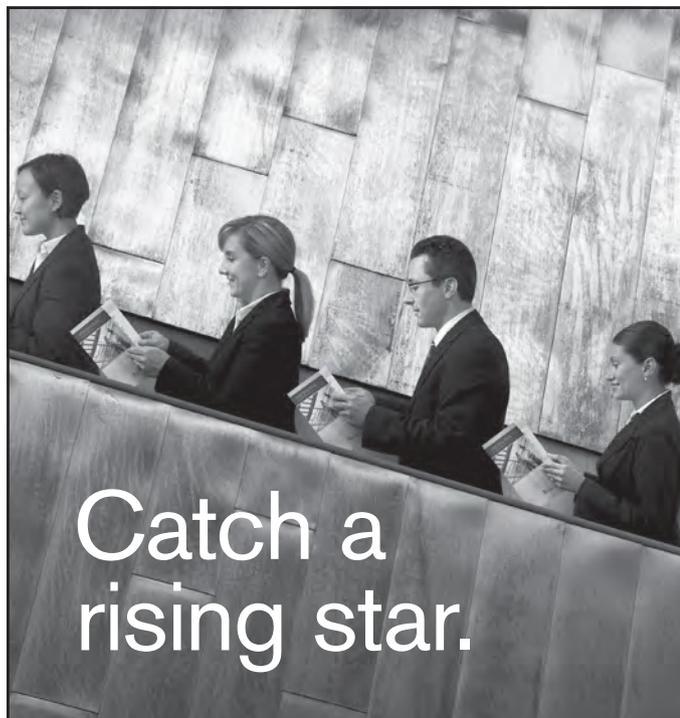
- 1 Maximizes the amount of available funding linked to current needs and assets rather than net worth.
- 1 Improve profits by taking advantage of supplier discounts.
- 1 Minimal financial covenants: increase company's financial flexibility.
- 1 Lending decisions are also based on the strength of the company's assets as well as minimum financial results.
- 1 Provides stability of funding as borrowing criteria is clearly understood by the borrower.
- 1 Ongoing field exams and inventory appraisals are conducted which enables banks to better understand the borrower's business.

- 1 Improve sales by providing extended/more competitive terms to debtors.

Considering that the advantages of an ABF are attractive, a business that decides to pursue an ABF must first spend the time and effort preparing for the reporting requirements of an ABF working capital line of credit. As ABF lenders lend against accounts receivables and inventory, these lenders need frequent information on the assets they are financing. This requires not only time from the borrower, but there is also a cost involved in the frequently appraisals of the assets and the administrative work involved for the lender and borrower.

Although both the traditional operating loans and ABF have their advantages, a borrower should speak to their financial advisors to see which financing vehicle will better satisfy their credit needs. ▀

Christian Kokorian, MBA, CMA, works as a senior commercial account manager for a major Canadian bank and teaches finance in a graduate certificate program at McGill University.



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A leaner IT — seven targets for waste reduction

Decision makers have to look everywhere for ways to cut costs. One approach is to identify and eliminate waste — much the way lean methodology is applied to manufacturing.

By Jacob Stoller

North American organizations spend over \$500 billion annually on IT, making it a prime candidate for cost-cutting initiatives. Cuts to IT, however, can be risky — no organization can afford to disable the cost-saving functionality that IT provides, or to compromise systems that have become a vital link to customers and business partners.

A sensible approach is to identify and eliminate the waste in IT — much the way lean practitioners attack what are called the “Seven Wastes in Manufacturing.” While there are fundamental differences between a shop floor and a data centre, the same basic principle applies — find activities that don’t add value, and eliminate them. Here are some seven suggested targets:

1) Too many servers. Data centres have grown rapidly in the last decade and many organizations have accumulated large “farms” of rack-mounted servers. While this modular approach provides convenient physical boundaries between

applications, it is inefficient — many organizations have high percentages — often 50 per cent or more — of unused capacity. Because each machine takes up space, and has to be powered, cooled, and maintained, this results in significant waste.



Illustration: Sean O'Rourke



Server virtualization technology allows organizations to consolidate their server functionality into a smaller number of machines while maintaining the logical divisions between applications for operations and security purposes. This eliminates excess capacity and significantly reduces support and operation costs. Organizations report that investments in server virtualization quickly pay for themselves through energy savings alone.

2) Excessive or inefficient printing. The paperless office that was promised decades ago never happened — people print more than ever and controlling printing costs needs to be a part of every IT strategy.

The paperless office that was promised decades ago never happened — people print more than ever and controlling printing costs needs to be a part of every IT strategy.

The first waste target here should be local inkjet printers, fax machines and copiers. These devices are cheap to buy, but expensive to operate — costs per page are three or four times that of their larger counterparts. Centralized units that consolidate printing, copying, scanning, and fax are not only more economical, but can be leased on a per-page basis, making

it easy to allocate costs to end-users. This helps organizations control expenses and promote conservation — an individual might be a little less likely to print extra copies of a report if his or her boss is going to get the bill. Furthermore, a centralized approach makes it easier to set defaults to lower cost modes of printing, such as black and white or draft quality.

Some organizations are also reducing printing costs by equipping users with dual monitors. With a

roomier virtual desktop, there is no need to print invoices, spreadsheets, and other documents in order to refer to them while creating another document — they can easily be viewed on a second screen.

3) Unnecessary power consumption. The average PC workstation consumes the equivalent of two 60-watt light bulbs. There's no truth to the long-standing myth that it is "bad" for computers to be turned off every night.

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The same rule can be applied to printers, modems and other electronic devices. Sleep or standby mode may not do the trick — often devices use almost as much power in these modes as they do during normal operation. In a smaller office, it makes sense to put these devices on a power bar and turn them off every night at the source.

4) Unused software licenses. Organizations often pay for software licenses that they don't need and don't use. License agreements should be reviewed on a regular basis to eliminate this kind of waste. This oversight is made easier by software programs that track application usage and calculate how coverage can be optimized. These systems are particularly helpful in large multi-application environments and where applications are licensed on a simultaneous user basis. They also help prevent license violations.

For many Canadian organizations, Microsoft Office represents a significant portion of licensing costs and this should be reviewed carefully. Going with Office Standard instead of Office Professional may be a better fit for many or all of an organization's employees, and in some cases, it may be more practical to license a single application like Word instead of licensing the entire Office suite.

Another option worth exploring is open-source products such as Open Office. Compatibility is much less problematic than it used to be — Open Office can easily read and create Microsoft Office files. Larger organizations, however, should be cautious, as enterprise applications might have reporting features, for example, that are linked to a Microsoft Office application like Excel.

5) Telecommunications cost overruns.

Telecommunications costs are high in Canada, and many organizations are concerned that they're getting out of control. With employees talking, emailing, browsing, and text messaging from a growing arsenal of mobile devices, bills are getting not only larger, but complex. Buyers may find it difficult to verify that they are being billed correctly, that they have the most cost-effective plan, and most importantly, that

employees are not wasting these costly services.

A number of products and services are available that help organizations track telecommunications costs by end-user. This can help eliminate unnecessary subscriptions, optimize coverage plans, allocate costs to end-users and promote responsible usage.

6) Obsolete systems. Many companies hang on to older legacy systems because they don't want to deal with the hassle of migrating them. Like the old refrigerator in the basement, these hum along in the background, quietly taking up space and resources. Data conversion tools have improved substantially in recent years and it's a lot easier to decommission older systems.

Data conversion tools have improved substantially in recent years and it's a lot easier to decommission older systems.

7) High-priced training. It's vital that IT staff be kept current on the latest technology, but IT training can be a huge cost drain — when course, travel, hotels, time off, and lost productivity are factored in, it can cost upwards of \$8000 to send an employee on a week's training.

Classroom training can be a very wasteful option for many types of content. Technical details such as commands, screen sequences and settings can easily be learned in a self-directed, online format, and employees often find this method better suited to their learning style. Furthermore, generic online courses are available on many subjects and products, including courses that lead to certification. For a nominal fee, employees can be given a membership in an organization like ACM (Association for Computing Machinery), which provides unlimited access to hundreds of online courses.

Of course, in many situations, such as advanced courses, it's important that employees learn from a subject matter expert, receive feedback, and interact with peers. Online training, therefore, should complement, rather than replace, classroom training.

The Bottom line

Cost cutting shouldn't be a matter of applying the axe, but of developing a permanent ability to identify and eliminate waste. As with any continuous improvement process, this takes constant vigilance and a significant dialogue with customers — in this case, the end users of IT. The most important challenge is being able to determine where IT provides value to the organization, and where it doesn't. ⁿ

Jacob Stoller (jacob@stollerstrategies.com) is a Toronto-based independent writer and researcher.



Tax-exempt status preserved despite sophisticated operations

A recent Tax Court of Canada decision confirms that not-for-profit organizations can adopt the good practices, efficiencies and activities of a well-run business without jeopardizing their tax-exempt status.

By Greg Richards

A significant income tax advantage — indeed, an exemption — awaits a corporation that can successfully prove it is a not-for-profit organization within the meaning of paragraph 149(1) (l) of the Income Tax Act (ITA). So when that not-for-profit status is challenged, the stakes are high and a defence can be essential for ensuring the continued operations of the organization. Such a defence was successful in the recent decision of the Tax Court of Canada in *BBM Canada (formerly BBM Bureau of Measurement) v. The Queen, 2008 TCC 341 (CanLII)*. The BBM decision highlights that, even though sophisticated activities are carried on within a not-for-profit entity, the entity may nevertheless be exempt from paying income tax by meeting various tests set out in the ITA.

In order to win the case, BBM had to establish that it was both organized and operated exclusively for a purpose other than profit.

BBM: Canada's rating agency

BBM, originally known as the Bureau of Broadcast Measurement, was established over 60 years ago as a non-share capital corporation set



Illustration: Sean O'Rourke

up to provide impartial and accurate audience measurement data to its members. Today, its voting members are comprised of Canadian television and radio broadcasters, advertising agencies and representative advertisers, and its non-voting members include universities and government agencies such as Statistics Canada. BBM's functional counterpart in the United States, A.C. Nielsen, is a for-profit company known for its "Nielsen ratings." BBM has performed this ratings function across Canada since BBM's inception, but significantly, as a not-for-profit entity.

Broadcasters are willing to pay for BBM's audience measurement data in order to make program decisions and to show the depth and reach of their programming in order to sell advertising. Advertisers and advertising agencies have similar interests, but use the information to help in the strategic purchase of advertising space. Each sector of the industry wants to know the size and type of audiences associated with broadcast programs.



Industry players become members of BBM and pay their annual membership fees to obtain the data. BBM sets its fees on an anticipated cost recovery basis according to annual budgets set for each upcoming year. In some years, however, surpluses are earned, while in other years, deficits are incurred. Surpluses are not distributed to the members, but used to further BBM's purposes.

The court rejected the Crown's arguments and found it was legitimate for non-profit entities to operate in a business-like manner and to avoid waste and capture efficiencies without becoming a for-profit organization.

BBM catches CRA's attention

Audience measurement has always been a complex activity involving surveys and statistical analysis, but with the advent of modern electronic measurement tools, the activity has become increasingly sophisticated, capital-intensive and expensive. In 1996, the tax year at issue, BBM employed approximately 300 persons and achieved an operating surplus of over \$2 million, with income primarily derived from the fees of its members. The organization's accumulated surplus by that point was approaching \$7 million. BBM planned to invest these funds in new electronic measuring equipment in future years. But the operating surplus, and the fact that BBM had a "for-profit" subsidiary conducting custom survey work, attracted the attention of Canada Revenue Agency (CRA). Under paragraph 149(1)(l) of the ITA, a club, society or association that is not a charity is exempt from paying income tax if it is "... organized and operated exclusively ... for any other purpose except profit ...". CRA challenged BBM's not-for-profit status and

assessed the company for income taxes approaching \$1 million. BBM objected to the assessment. CRA denied the objection and confirmed its assessment and BBM then filed a notice of appeal to the Tax Court of Canada. The fight was on.

The trial of the appeal

In order to win the case, BBM had to establish that it was both organized and operated exclusively for a purpose other than profit. It submitted evidence concerning the manner in which BBM was established (letters, patent, by-laws and the like) as well as evidence concerning the details of its day-to-day operations. The Crown argued that an organization cannot be considered to be organized and operated exclusively for a purpose other than profit if the establishment or operations of the entity are related to the commercial or business activity of its members or of others. The thrust of the Crown's case was that BBM failed to meet the requirements of the ITA because its purpose was to provide audience measurement data to members that include industry giants such as CBC, CTV and Global, and the data assisted the members in furthering their commercial and business activities. The Crown also cited CRA's Interpretation Bulletin (IT-496) that points to several "badges" of a profit-oriented enterprise, including the realization of profits, the accumulation of reserves, the entity operating in a normal commercial manner, goods and services being sold to non-members and the entity's operations being in competition with taxable entities. The court rejected the Crown's arguments and found it was legitimate for not-for-profit entities to operate in a business-like manner and to avoid waste and capture efficiencies without becoming a for-profit organization. Justice Patrick Boyle of the Tax Court of Canada made note of a number of multi-million dollar organizations, including the Canadian Bar Insurance Association, the Canadian Medical Protective Association and the real estate boards of major urban centres that are run as not-for-profits. In the end, Justice Boyle's analysis came down to this key point:

"The operations of not-for-profit entities like BBM lack a significant attribute of commercial businesses. There is no opportunity for their shareholders, members, or controlling persons to benefit financially by way of profits, distributions, unrestricted salaries, capital appreciation of the undertaking or its assets, or in similar fashion." Justice Boyle allowed BBM's appeal with costs. The Crown did not appeal and BBM's tax-exempt status was preserved.

Sophistication — but not taxation

The BBM case shows that highly sophisticated activities may be conducted within an entity that is run on a not-for-profit basis without jeopardizing the entity's tax-exempt status. This allows a non-for-profit entity to devote all its revenue, net of costs, to its not-for-profit goals and objectives. The BBM decision helps to preserve this significant tax benefit for those using the not-for-profit model. ▀

Greg Richards (grichards@weirfoulds.com) is a partner with WeirFoulds LLP in Toronto.

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LLB, LL.M., MBA, CMA, CFI, CFE, DIFA
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Clean coal and carbon capture — the next Kyoto battleground

Carbon capture may prove to be beneficial in the fight against carbon dioxide and global warming and help cut down on air pollution.

By Peter Ion

The economic downturn has been cited as a probable cause for environmental issues to take a back seat in the boardroom and the reason political leaders will likely re-strategize their latest green-shift policies. Although consumers are still expected to account for every gram of their carbon footprint, the latest methods of accounting for our national greenhouse gas budget is focusing on the real culprits — the heavy emitters of industry. Amongst the most promising techniques gaining credibility are the ones through carbon capture and sequestration (CCS).

As the latest gadget in the Kyoto toolkit, the idea of injecting the CO₂ that would normally escape into the atmosphere and back into the ground from where it originated (oil, natural gas or coal) is finding favour. From an accounting perspective, the technique is a potentially ingenious one whereby a cost, that of an existing power generation facility, is transformed into a real opportunity for financial gain.

In terms of the return on investment, the “bridging solution” involves injecting waste by-product CO₂ from the burning of coal (or gasification processes) into abandoned oil wells that have been traditionally classed as too mature to be tapped by existing technologies. Canada has a pre-eminence in this technology and is well placed to take full advantage of the win-win opportunities generated by the use of CCS techniques for enhanced oil recovery (EOR). The world’s largest land-based EOR project has been in operation for over a decade now at Weyburn in Saskatchewan. Last summer, it received a boost as Shell committed



to support the continuation of the project well into the next decade. Additional sites for CO₂ sequestration are also being actively assessed in north-east British Columbia.

The U.S. Department of Energy estimates that there is a potential to recover 43 billion barrels of oil through EOR techniques. As the current proven reserves in the U.S. are in the region of 28 billion barrels, it is akin to rediscovering oil all over

again. As the price of a barrel of oil reached US\$150 last summer, the estimated value of this additional recovery would be in the region of US\$6 trillion.

Paving the way for the future

Coal is here to stay, at least for the foreseeable future. U.S. president Barack Obama’s administration will include two respected climate scientists as its chief environmental officers. This represents the strongest signal yet that the U.S. will commit to joining the party at Copenhagen later this year, when the “new and improved” Kyoto Protocol is introduced to the world.

According to Dr. Fatih Birol, chief economist with the International Energy Agency, China alone will build 800 gigawatts (GW) of additional capacity in the next eight years, 90 per cent of which will be coal fired. This equates to the entire power generation build of Europe since the end of World War II. The average lifetime of these new builds is in the region of 60 years. Effectively, if Europe were to achieve its target of a 20 per cent reduction in emissions by 2020 (similar to Canada’s own unachievable targets) then the cumulative emissions reduction of those 12 years to 2020 would be equal to only 60 per cent of one year of emissions in India and China.



Table 1 — CCS Country Attractiveness Index

Near Term Rank	Country	Near term Index	Long Term Rank	Country	Long Term Index
1	USA	76	1	USA	71
2	UK	69	2	China	67
3	Canada	65	3	Russia	65
4	Australia	63	3	Germany	65
5	Netherlands	61	5	India	62
6	Norway	59	6	South Africa	60
6	Germany	59	7	Australia	59
8	France	50	8	Canada	58
9	Japan	47	8	UK	58
9	China	47	10	Japan	56

Source : Ernst & Young, energy and environment infrastructure advisory group, 2007.

Clean coal is coal that is burnt and the resulting CO₂ captured is buried underground where it stays indefinitely. The proven statistic that a tonne of injected CO₂ can lead to the assisted recovery of between five and seven barrels of incremental oil makes the argument for CCS additionally compelling. At a cost of capture between US\$25 and US\$40 per barrel, the process of EOR becomes an investment rather than a cost.

So who should pay for this “cost of capture?” Should the taxpayer cover the bill through government subsidy or should the consumer be expected to pay through increased utility bills? The Canadian government, similar to other resource-based economies such as Australia, is going to provide “matching” grants to industry, paralleling the contributions of private enterprises that will be responsible for implementing the necessary technologies. The Norwegians, who have been injecting CO₂ into saline aquifers offshore for many years now have been applying a US\$50 a tonne carbon tax to cover the additional costs.

Canada has achieved another world first with its strategy of CCS/EOR. Saskatchewan-based HTC Energy bases its product development centre at the University of Regina. A multidisciplinary complex of establishments includes the International Test Centre for CO₂ and a coal-fired flue gas pre-commercial scale demonstration plant at Estevan. With laboratory and research experience in carbon capture that now extends to over a decade, the facility is globally unique.

By diversifying their product offering, they are

well placed to take full advantage of the growth in the CO₂-disposal market. This includes carbon-dioxide modeling, design and simulation. The company also holds IP rights for designer solvents, packing materials and process-flow designs that increase capture efficiency. Their trademarked Purenergy CCS CO₂ Capture System is pre-engineered, pre-built and modularly constructed by strategic partners Pinnacle Industrial Services of Regina and NuVision Industries of Carseland Alberta. The intelligence is embedded in a modular design that can be manufactured, shipped and installed at a lower cost than that of a retrofit to an existing facility. When the alternative is the permanent installation of above-ground or buried pipeline to transport CO₂ from source to sink, with costs running into the tens of millions, the ‘modularity’ concept is commercially irresistible.

Their proprietary thermal kinetics optimisation (TKO) process is designed to directly reduce the largest single cost of CO₂ capture — the use of power plant steam — to a ratio of below one unit of steam required to one unit of CO₂ captured. Although the organization makes no mention of this, the fact is, the steam that would otherwise be vented to the atmosphere is also a greenhouse gas that contributes to warming.

A Canadian leader

Saskatchewan is proving to be a national leader for CCS technology. In a province of uranium production, any new power generation projects will be benchmarked against the nuclear possibilities, including new power plants powered by locally-sourced fuel supplies to the north. CCS was part of the equation in the recent rethink about the Boundary Dam proposal in which the initial idea of a new build was revised in response to the need to incorporate “CO₂ value.” The novel concepts of matching CO₂ flow rates (from power generation processes) to CO₂ market needs (most likely from depleted oil wells in need of rejuvenation) was largely responsible for a complete rethink by Saskatchewan Power Corporation in recent months. Clearly, CO₂ is now a determinant of design — 15 years ago it would have been an insignificant by-product of electrical generation.

With hydrogen-based infrastructure projects still springing up across the



world, Canada has scored yet another first by patenting a technology that will make commercial use of this gas, as well as effectively dealing with the CO₂. Atlantic Hydrogen Inc. secured financing from the EnCana Environmental Innovation Fund and the New Brunswick Climate Change Action Fund that will support the CarbonSaver Demonstration Project in Fredericton. By applying an electrical charge to natural gas, the hydrogen and carbon can be split to be saved (possibly for hydrogen fuel cell use) and stored (as a carbon solid) respectively. With credit for carbon capture likely to be included as a legitimate process within Kyoto's Clean Development Mechanism (although its progress was stalled at the recent Poznan meeting in December) and hydrogen being a high-return fuel feedstock, this is a case of two potential revenue streams from one natural gas stream.

The problem at the moment is that with so much of this technology still in the demonstration phase and the long-term fate of the injected CO₂ still unknown (other than a handful of sites such as Weyburn in Saskatchewan) for working projects, the risk in trying to regulate undeveloped technology such as this is high. The industry buzz phrase is "capture-readiness" (CR) and the general consensus is that CR requirements in natural gas plant permits are much too vague.

Dr. Nils Markusson at the School of Geosciences, University of Edinburgh, comments that 'regulating technology that has not been fully developed is never easy. If you regulate too early there is too much uncertainty involved and the properties of the ready-to-use technology cannot be predicted. Alternatively, if you regulate too late, when the technology is already on the market, there is a risk that it has become entrenched - locked in - and then it is then very difficult to change.' It is not just about having the space to build a CCS unit to an existing plant, or to include it as an integral part of a new design (the Chinese are apparently building a new coal-powered plant every four days) but it's all about identifying routes for transport and storage.

There is also the need for a lot of political will to impose abatement technology — in the European Union (EU), it took years to get high-sulphur coal accepted for use once the necessary

flue gas desulphurisation technology was fitted to the stations. Coal had to be 'clean' in terms of sulphur long before it had to be "clean" of CO₂, and based on that experience in the 1990s it is likely that the earliest full-chain, full-scale demonstrations will be operational in 2012. Retrofitting of CR plants could be mandated within three years of that date. As an investment opportunity, coal has never looked so bright and promising.

As with most emissions abatement-related initiatives, the Canadians should be, and by most accounts are, looking to the EU for the various possibilities for incentivising the introduction of CCS technologies. There are three major avenues that should be explored:

- i) Introduction of a sort of "decarbonized renewable obligations certificate" (mandating a certain percentage of power generation to come from plants fitted with CCR technology) that would grant CCS the same level of support as has been made available to offshore wind power generation.
- ii) Deriving feed-in-tariffs to guarantee a higher price for electricity generated by CCS (probably at a higher level than the solar and micro-hydro projects that are in place in Ontario at the moment).
- iii) Integration within the EU Emissions Trading System (or one of the regional North American geosequestration associations now in existence) to reward the process of CO₂ successfully stored underground.

Ernst & Young recently undertook a global survey to determine a "CCS Attractiveness Index," in which the investment climate for CCS was determined for nations in which coal-burning contributes significantly to the power mix (Table 1). The weighted index considers regulatory risk, planning and network connection issues (including public acceptability of CCS), access to finance, power off-take attractiveness, tax climate, grant/soft loan availability, market growth potential, current installed base, emitting plant age and the share of fossil fuel capacity (weighting coal higher than oil/gas). Their index differentiates between long-term and near-term attractiveness — in which the near term describes large scale deployment in the period leading up to 2015. Structural factors are less important for the near term ranking, whereas government loans, subsidies and tax incentives are given greater weighting. Canada ranks third to the U.S. and the UK in this category which suggests a positive investment climate, whereas other countries with more ambitious claims for their generation beyond 2015 rise above Canada.

The case for CCS has received some open hostility from organizations that might otherwise have been considered supportive. Greenpeace has been very critical of the possibilities, labeling CCS a "false solution." Even the Australians, who rely on the Chinese as their key coal export market, are focusing their energies on CCS. Their "Australian of the Year" in 2007, Tim Flannery, (similar to Canadian icon, David Suzuki) has talked about coal losing its "social license," much in the same way that asbestos has already lost its place in society. In reality, it may seem way off yet; however, it does set the stage for the PR battle that clean coal capture and sequestration will have to win in the months and years ahead — Canada is fully engaged in this battle and is very far from losing. ²¹

Peter Ion, M.Sc, MBA, (pete-van@hotmail.com), is a Vancouver-based technical author with specializations in alternative energy, emissions accounting and related business environmental issues.



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