



Course plan

- If you want to watch this in sections, here are the time stamps for the topics
- Introduction & general 00:00
- Financial reporting 00:19
- Banking 1:48
- Ethics 3:14
- Foreign exchange 5:20
- Contracts 6:20
- Interviewing 6:56

SEMINAR INFORMATION

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Seminar 1400

BEAN COUNTING FOR BEAN COUNTERS



Bean counting – why?



- Tomorrow at work...
- Ethics test since a topic today
- We will find out who is the bean counter of the year (they will get a certificate) and they will also win the beans!
- I will ensure you can win next time you are asked to guess – I will give you the science behind bean counting

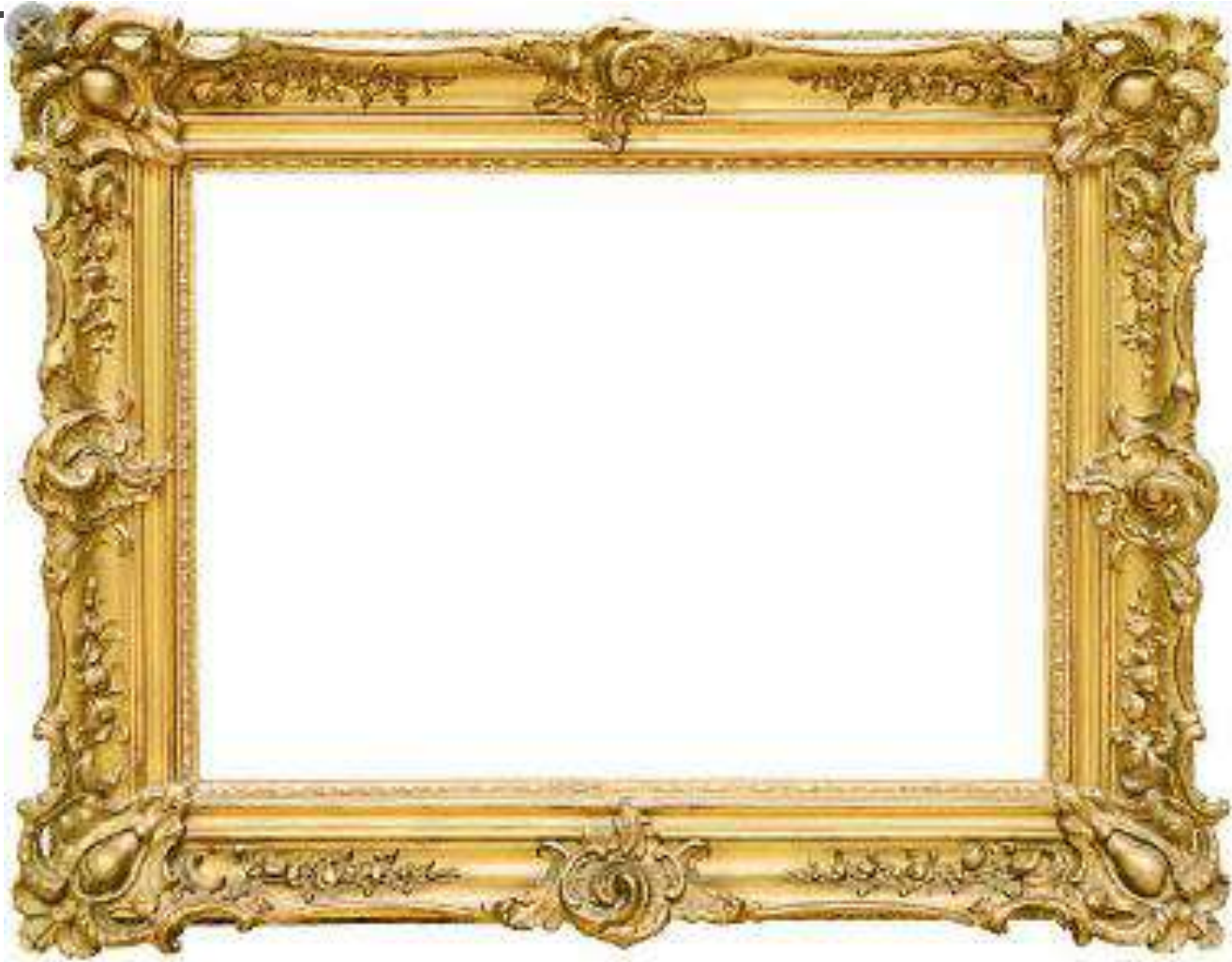
***QUEBEC
BEAN COUNTER OF THE YEAR***

AWARDED TO



**BY PRACTICAL PD
SEMINARS FOR ACCOUNTANTS
June 18, 2020
www.practicalpd.com**

Someone asked, do I get a
frame?!!



Yes

Do you have foreign currency risks? Are they significant?

Only on my personal account. To me they are.

Do you enter into any forward contracts or use other instruments to hedge foreign currency risks?

No

Have you ever negotiated or helped negotiate a financing offer from a bank?

Yes

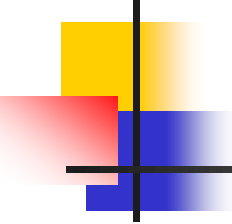
What is your organizations' main bank?

* Cross-town Credit Union

Do your colleagues call you a bean counter?

Yes, and other words

"The Accountant" with Ben Aflack has
diminished my reputation though.

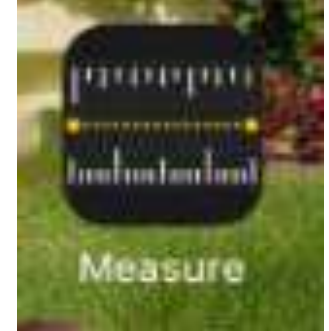


How did you win? What was your system?

- Some say layers – it doesn't work
- One guy said I just guessed my birth year's last two digits..



Bean counting science



- Measure/estimate volume of container in cubic centimetres
- (Volume of a cylinder is $\pi r^2 h$)
- Multiply by 0.37 to get a very good estimate of the number of standard-size jelly beans
- There are tape measure apps for your phone or else just estimate as best as you can!

A mall in BC, guess what I was thinking...





PRACTICAL TIPS FOR CONTROLLERS & CFOs - THE CASE COURSE

PRESENTED BY:

Stephen Priddle, CPA, CA, CMA

Ottawa, Ontario

VP, Finance & CFO & Corporate Secretary

SureWx Inc.

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**PRACTICAL
PD**



Different from this course

- Complementary and you would want to take both
- This has more and longer cases and discussions, the other one has more teaching

PRACTICAL TIPS FOR CONTROLLERS AND CFOS

www.practicalpd.com

Stephen Priddle, CPA, CA, CMA
VP, Finance & CFO & Secretary
SureWx Inc.

spriddle@bell.net

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PRACTICAL

PD

The seminar beside this seminar last year...





All you can
EAT Chocolate!
\$25 each or
\$15 for groups
of 5!
CJS



Introduction

- Welcome
- Admin matters
- Introductions – you
- Introduction – me



Course plan

- Financial reporting
- Banking
- Ethics
- Foreign exchange
- Contracts
- Interviewing



A course objective

- I want you to gather ideas, smarts, tips that you get you promoted!



Let's get to know each other

- Give us your name and a 30 second summary of your life story
- I am joking



Stand up and sit down if...

- You walked the dog this morning
- You believe you have a work/life balance
- There is open access, read-only to many area of your accounting system for non-finance people... **(that's what some of the literature says is/should be happening, I am sure we all have reservations about the idea)**



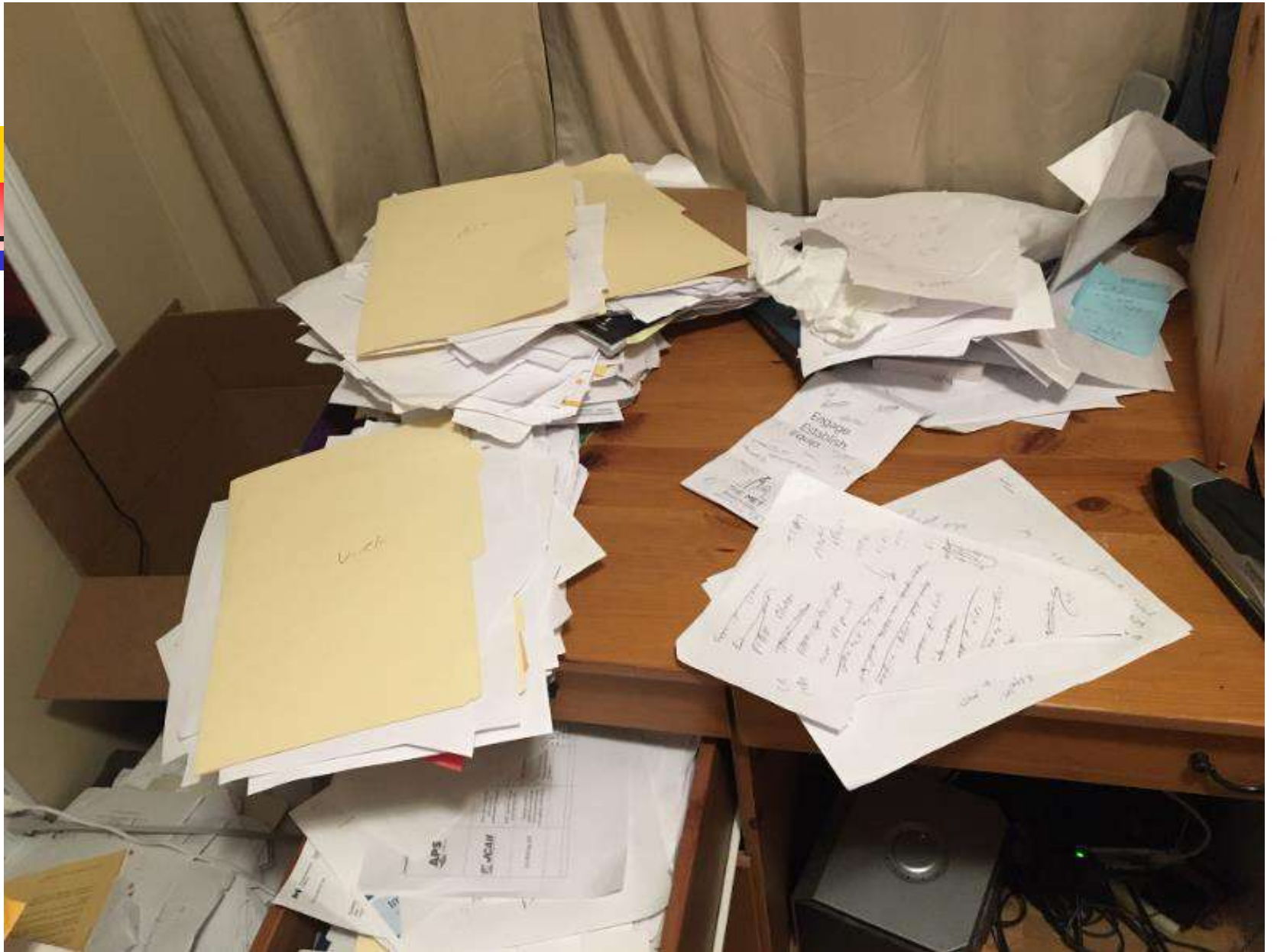
Stand up and sit down if

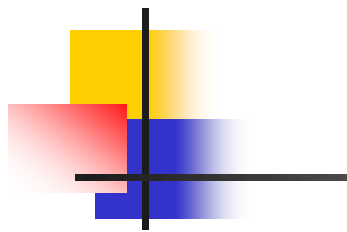
- You have worked outside of Canada after getting your designation



Stand up and sit down if...

- Plan to retire at 55
- You had a shower this morning
- You believe you are underpaid
- You report under IFRS accounting standards
- You drink coffee
- (This question helped my marriage)
- You have a messy desk







If a cluttered desk is a sign
of a cluttered mind, of what,
then, is an empty desk a sign?

Albert Einstein



I have had different bosses

- One who never had a paper on his desk (or a computer) – I am sure my desk bugged him...
- Another said, “can I send my assistant to help you tidy up and get organized...”



Stand up and sit down if...

- Usually brown bag it for lunch (bring your own, you don't buy)
- You have never got a speeding ticket (I asked this for a reason...)

Stand up and sit down if...

- You are so boring and unimaginative that you ... married another accountant, like I did...





Recent chat responses

From Joey : I did

From Armando : no

From saile : fortunately no

From Antonio Petruccelli, cpa, cma, acma to Stephen Priddle(Privately) : dating

From Armando : no thanks



Note

- Many accountants can't find a spouse because...
- Many accountants want to marry another accountant
- Many non-accountants hear accountants are well-paid and employable



Note

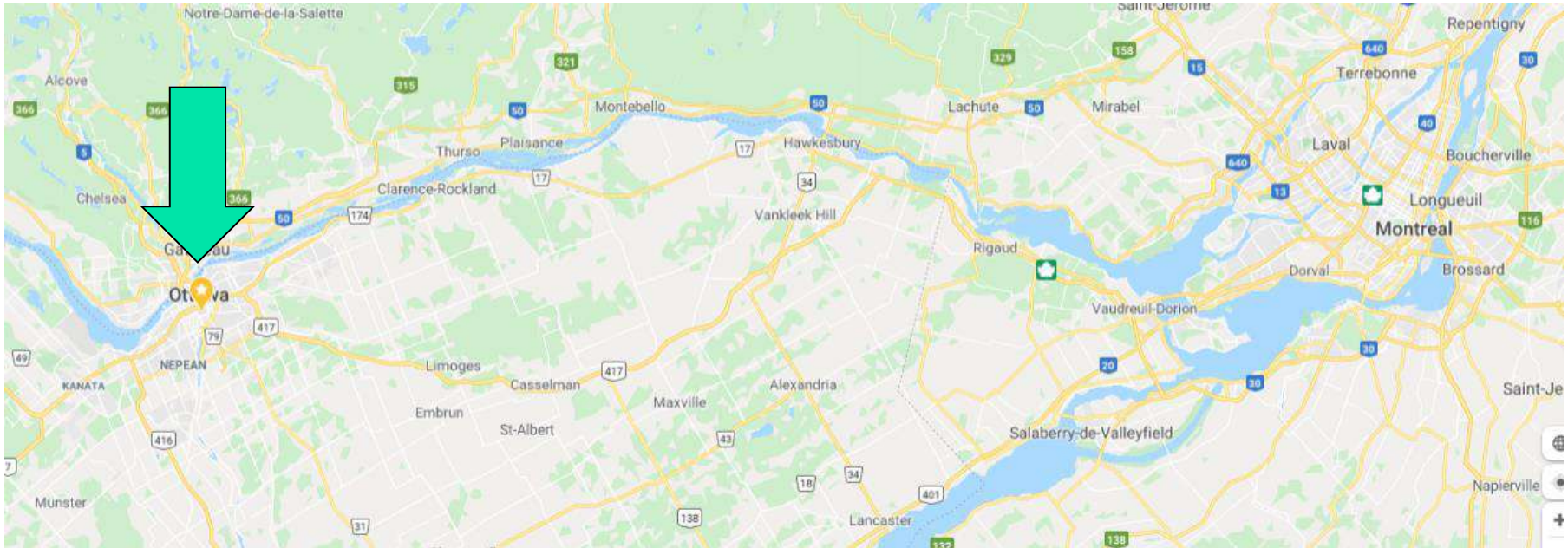
- So, I am doing something to help in this area
- Check out my site:
- www.accountantsmatch.com



Bio trivia

- I married an accountant
- We met on a dating site in the 1980s!
- My wedding was officiated by an accountant
- We stayed in cottages each owned by current or former accountants, KPMG tax partners!

Where am I?





For foreign audiences, I say





Actually

- some of them almost believe it





I am a world-renowned expert
in

- Funny tricks and games for my own grandchildren...!

At age 20, I became a CGA

- Yes, **Chief Gluing Assistant** in a federal government office, gluing paper on the evening shift... because I didn't want to go to university...
- I later became a **Certified General Accountant...**





Another career excerpt

- The move to treasury for four years...
- Short-term investments, banking, foreign exchange, letters of credit, commodity taxes, insurance & risk management

SureWx, helping flights in the winter – safer, less cancellations



My unpaid CFO job...family business



Patented fence technology

ENGLISH | FRENCH



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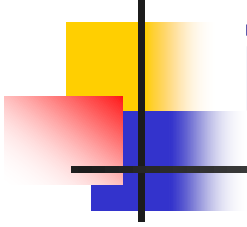


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This ensures your project will retain the maximum value possible well into the future. Print key elements of this site **eBrochure.**

My Dad has reported to some
interesting Quebec CEO's







Objectives

- To practice your skills in realistic case situations
- To get more ideas to help you in your work
- To see how other professionals approach the situations
- Although all your industries are different, the tip logic can often be applied to different industries



Don't be shy

- A few relevant jokes
- You can e-mail me questions later
- You must fill in the blanks, there is a reason for this... ..(but you will get completed slides after)
- Suggested approaches that will be handed out are not the only possible options
- You will be able to action some items at work



Introduction

- We will do a few mini surveys to help you
- Doesn't apply to your current job, but it may apply to a future position you take
- Not the textbook approach



New rule 140.4

- \$47 fine if you do any on-line shopping during any CPA PD session



Case #1

- 72 minute case
- Please write your response in a Word document, and email it me spriddle@bell.net
- A team of markers will grade them and return them to you, within 48 hours of receipt, with your national ranking in deciles...



Introduction

- Cases best simulate real life
- Have you ever marked professional accounting exams?
- Case Examination Bloopers

I have spent about 3 weeks of my life locked up in this hotel...marking exams (UFE)





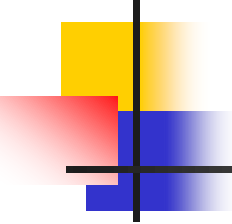
Marking professional exams

- A careful selection process
- Very diverse responses, since complex professional exams
- Days of training/practice exams before going live
- Some markers held back from going live, put in the “Gulag”, practicing until they are ready



Marking professional exams

- Extensive re-marking of papers
- Statistical trend analysis
- Bilingual marking teams, very fair
- Marking borderline submissions many times
- Making judgemental marking as consistent as possible



How does one stay sane
working intensely 12 hours a
day at the marking centre?



We collect exam bloopers

- *"Golf is popular because of the Tiger Woods phenomenon. Like disco, it will pass.."*
- *(First year in business)*
- *"Since this is a first time audit, we must qualify because we will be unable to verify the opening numbers"*
- *"This could be a disastrous audit"*



Exam bloopers

- *"We have two days to finish this audit, which is better than 84 minutes to finish this question"*
- *"I must assess whether I am competent to carry out this audit – I believe I am"*
- *The company has lost money for so many years, so it has become a Not-Profit-Organization"*
- *"As such, it does not need to follow the Handbook on income taxes..."*



Case exam bloopers

- *Since the company has lost money for a number of years, it has become a not for profit organization....*
- *As such, the future income tax section of the Handbook does not apply...*

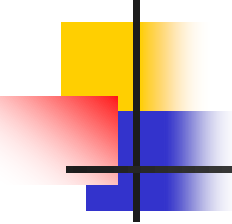


I authored some of the cases..

QUESTION 4 (25 marks) (60 minutes)

Ellen Weissman, a successful businesswoman, operates a medium sized retail business. She owns no real estate beyond her principal residence and what she requires for her business.

MANY UFE QUESTIONS - YOU MAY HAVE WRITTEN SOME...



A case purchaser, a professor from a major Montreal university once said...

- Your cases unfold like a Tarantino movie
- I had no idea what they were talking about I had to google Tarantino...



Exam nightmares....

- I still get them periodically
- A mild form of PTSD...



I got them on

- May 15, 2020
- And June 10, 2020



Exam nightmares....

- A mild form of PTSD...(Post Traumatic Stress Disorder)

Exam nightmares....

- A mild form of PTSD...





Improved financial reporting

- Whose main focus is financial reporting?
- Does anyone report on other than a monthly basis? (An alternate reporting idea: date the balance sheet was strongest)
- Are users satisfied with your reports
- Are you?



Improved financial reporting

- Do users read them?
- Why or why not?
- How do you find out whether they are reading them...
- Can you improve them?



One attendee said they wrote

- “The VP Sales was beamed up to Mars” in the Board report, and only 2 of the 6 members seemed to notice this...



Improved financial reporting

- An auditor perspective on financials...
- The key is useful information for user decision-making
- Sugar coat/spin doctor or tell it like it is for internal financial reporting?
- Question: too much versus too little info



Improve financial reporting

- More than numbers: the importance of useful narrative analysis
- Make the numbers speak
- Should provide the users with financial and business wisdom about the results
- Consider comparable public company MD&As for ideas for your company

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS



No crooked accounting!

- A woman wanted to know what $2 + 2$ was so she went and asked a _____

She asked

- An engineer
- A lawyer
- A statistician
- A humanities student
- An Arthur Anderson partner....



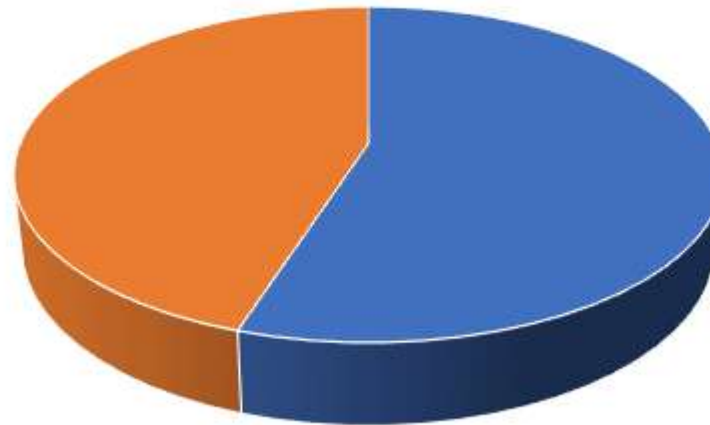


No crooked accounting!

- A woman wanted to know what $2 + 2$ was so she went and asked a _____
- Note: we don't do our financial reporting with a pre-determined result in mind, although someday, someone will say to you, "I don't like this result, can't it be _____"

Polling question – financial reporting ethics

Have you ever faced a financial reporting ethical dilemma?



■ Yes ■ No



Financial reporting case prep

- % completion accounting review
- Contract value x % complete
- % complete determined most appropriate way
- What is a holdback? a payment held back under certain conditions

All my live seminars/webinars have an opportunity to win prizes

I can't do that on the self-study version
BUT, send me an email with:

- example of how you plan to apply a tip
- another tip idea
- useful feedback
- clean relevant joke

and you will enter a draw for a prize
spriddle@bell.net



understanding their level fully. We check writers' ability to work under time pressure and do research of the most complex and rare topics. They know how to do an in-depth analysis, how to present results and how to make flawless formatting of your case study. All of our writers are Master's and Ph.D. degree holders, capable of dealing with the most complex case studies of any level.

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Wood Guys

Case study, Business Studies, Bachelor's (years 3-4)

10 pages

Deadline: 14 days (18 Jul 19, 4:29 PM)

Total price: \$160



Now time to read the case

- Scenario: improving the reporting for both Board and management
- Focus more on the reporting issues, than the business issues
- Don't criticize the reporting, suggest how to improve it!
- Think about a better monthly financial package, and also think KPIs! (30 plus)
- Put yourself in the Board's shoes



Note

- Remember to distinguish what actually was reported versus what is additional information in the case



What is the key to the case?

- Miscellaneous expense?
- Balance sheet out \$1?
- Suzie?
- Is Suzie a related party transaction?



Who is Suzie?



Who is Suzie?

- She is dating the President's son!



This Susie

- Was dating the case author's son, and now they are married!



Note

- My humour always get edited out of my published cases, but finally I am the editor....
- Names of auditors, were two Enron fraud villains



Once when I taught this case at a CPA conference...

- CPA Manitoba let a few college accounting students attend free, and sit together at a table
- Their comment after reading it...“the reporting package looks fine to us”
- You have learned a lot since you were in school!



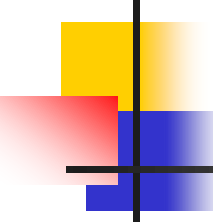
Opening comments

- Who works/has worked in construction?
- (You have more insight if you do, but everybody can learn from this case's principles for improvement)
- Don't just find problems with the reporting, suggest improvements
- Some people will say board members are superficial, they look at the f/s and say, "did we make money, are the covenants are on side, that's it! I would hope they would do more!"



Business issues

- Some CPAs want to focus on the business issues in the case
- There are lots – the company is having some trouble
- But the main focus is financial reporting improvements



What important single sentence
needs to be included in the
covering note to the financials to
the Board?

You should always include this monthly, unless it is stated elsewhere



- “The company is up to date on all statutory remittances.”
- Board members will be happy to see this, since they are legally at risk for source deductions, unremitted taxes...
- (Only about 10% of my attendees do this)



Also

- Also good to put “unaudited”
- For safety you might to put “preliminary” allows you to change numbers if you have to without embarrassment



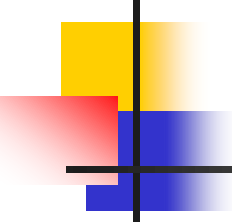
Other ideas

- The report would not lose anything if all numbers were in thousands
- It might be useful to report quarterly numbers as well

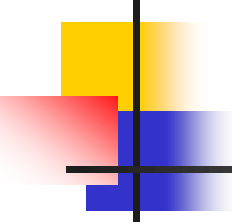


What are the major deficiencies?

- Lack of decision-oriented information
- An uninformative written analysis
- No useful schedules
- No looking ahead at all
- Poor comparatives



A big question that
participants don't usually deal
with up front



A big question that participants don't usually deal with up front

- What is the basis of reporting?
- Many are confused about this

GAAP

- Does GAAP need to be followed strictly in internal monthly financials? No!
- But bank covenants, probably have requirement
- GAAP will be required at year end
- So one might as well do GAAP monthly, or at least disclose material departures from GAAP
- Not that anybody does full GAAP notes monthly!





Are there any historic problems?

- Poor past financial reporting
- No CPA in charge!
- Uninformed senior management
- And possibly more....

Are there any historic problems?

- A detailed review of revenue recognition on contracts should be conducted since this is an area which might be prone to error & it is key
- Key tips about discovering historic inherited problems are found in my course **Practical Tips for Controllers & CFOs**



Let's discuss financial statement users

They include:

- Management
- The Board
- Presumably, the Bank



Idea



- Have a meeting with each of the organization's executives and the Board
- Find out if they are satisfied with the financial information they are getting
- This is especially important to do with the VP, Construction, probably the most important exec, who doesn't understand the financial reporting

A new board member

- What should you do?
- Consideration could be given to providing them a one or two page summary on the organization's finances: contracts and recognition, bank line and etc.
- Or an have in-person orientation





Big picture

- Discuss the month's results versus the company's overall strategy
- Discuss the macro-economy versus the results
- Discuss the business environment and the results, tariffs and more
- Discuss competition in relation to results



Consider a risks and opportunities discussion

- Risks including project/technical, currency, credit, petroleum price, competitive
- Some call it upsides and downsides



Consider reporting the items
that will impact final reported
results for the year

SOMETHING CORPORATION

YEAR ENDING DECEMBER 31, 2020

CURRENT VIEW OF PRE-TAX INCOME

675,888

UPSIDE

DECEMBER SALES AT THE END OF THE FORECAST

150,000

PROJECT MARK 10% MORE COMPLETE THAN EXPECTED

32,000

DECISION ON BIRD CONTRACT RECOGNITION

60,000

TERMINATION OF ZERK CONTRACT

40,000

282,000

DOWNSIDE

FINAL INVENTORY VALUATION RESULTS

25,000

AUDITORS WON'T ACCEPT ACCOUNTING FOR X

40,000

GOODWILL IMPAIRMENT HAS TO BE BOOKED

100,000

SUE CO. LAWSUIT STICKS

150,000

315,000

ALL UPS AND DOWNS PRE-TAX INCOME

642,888



Consider reporting the items that will impact final reported results for the year

- Once I did this for a COO and he said “Wow, I never understood it like this before...”



Management estimates

- It is a good practice to disclose significant management estimates
- This de-risks management if they wrong, and means the Board is less likely to get surprised
- Specifically, the board should be told that management has estimated that the Philips Limited and Rio receivables are collectible, rather than the estimate being made but not disclosed



Currency risk

- There is currency risk in the company since the company's position is not to hedge currency risks
- The Board has no idea what the magnitude of the exchange risks faced is, at least this could be quantified
- The Board might want to revisit the no hedging position in due course

Position with respect to its bank covenants



- The current position and the actual covenants should be disclosed
- Currently at 1.53 for current ratio, versus minimum of 1.5, very tight and a concern
- 1.88 for the debt-to-equity covenant, versus 2.25 maximum, reasonable
- Does anyone know Canada's debt-to-equity ratio?
- It was 2.28 last time I checked, but before COVID-19, much worse now






Stress-test

- If an allowance for doubtful accounts is recorded for the \$67K Phillips A/R the current ratio bank covenant will go off-side, which likely means the bank can call all the loans...
- This will get worse if the \$164K Rio also must be written off
- We don't have enough information to finalize this

Future-Oriented-Financial Information



- The Board and management are likely very interested in projected results for October, November and December, toward year end 
- Some forward-looking information for these months should be provided, even if it is harder to develop and entails the risk of being shown wrong



Percentages

- Showing key percentages in the financials is useful
- Margin %
- Expenses as % of revenue
- Assets as a % of total assets
- And possibly more



Accounting note

- I was once a 38 year old CFO and designated accountant, but I had never booked an entry in an accounting system!
- I had verified, proposed, supervised, ordered hundreds and hundreds of them
- So I did one, one day, and I finally felt like a real accountant!
- If you have never done one....

Let's discuss the income statement





Break-even

- Disclosure of the organization's approximate monthly break-even revenue would be relevant to users
- Do you know what your break-even level is?



Good comparatives are important

- One day an accountant was walking in the downtown of a big city...

Good comparatives are important

- One day an accountant was walking in the downtown of a big city...





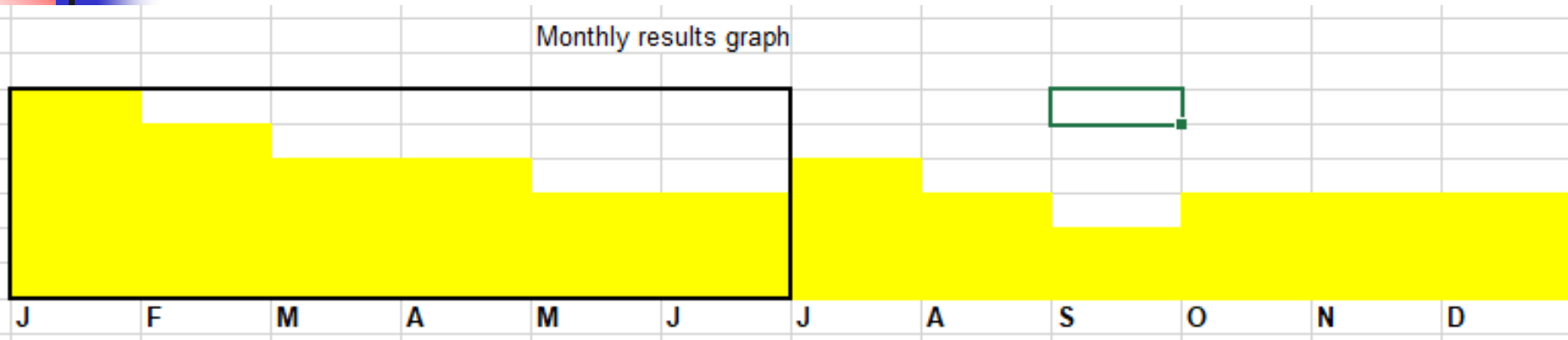
Good comparatives are important

- September prior year comparative monthly and YTD income statement information would be more useful because of seasonality
- Comparative September 30 balance sheet information would also provide a perspective of a comparison to the same date in the prior year

A better way to report comparatives

Problem, seasonality

Monthly results graph



- Solution, 12 month rolling comparatives, also know as TTM
- You will need to clarify differences from the budget year, although some organizations are adopting a rolling budget...



A better way to report comparatives

- Reporting rolling 12 month results with rolling 12 month comparatives is one of the best ways to see overall trends in the organization
- This is an excellent tip – few organizations report this way
- It removes seasonality and really tells you the velocity of the organization, important, even if there is no seasonality



Revenues

- In many businesses, revenues in a month are very sensitive to the number of working days, typically from 19-22 in a month
- This caused once CEO of mine so much stress that we almost thought of changing the reporting basis to try to deal with this, but we didn't
- We did report revenue per day, with comparatives to help



Did you note

- That the company may hit \$20M in revenues for the first time ever
- Sometimes certain round numbers are important, a \$10M, \$20M, \$100M, \$1B company
- This could be discussed in the narrative
- When I was taking a company IPO we focussed every week on whether we would reach a certain revenue number¹²³

Different ways of rolling up results that would be useful

- Can you think of any?





Roll ups

- Public companies have to segment information
- Not required for a private company but would you be useful
- What segments could you think of?



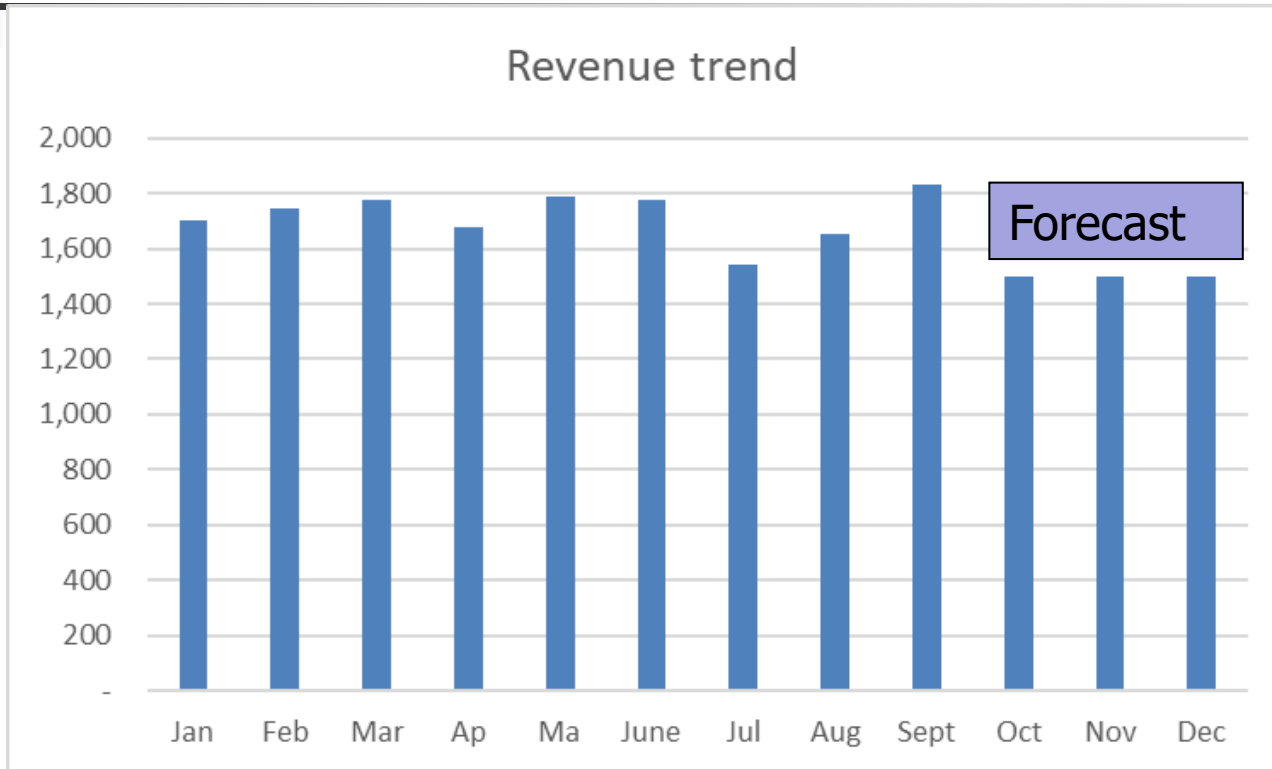
Possible segments

- By geography
- By industry we are selling to (plastic, trucking)
- Maybe some segments are doing better/worse than others and management doesn't know
- If the system can only report the revenues by segment, not the bottom line, that is still an improvement
- It is not clear what the corporate overhead is, this could be broken out
- (If you can analyze business trends and see things that others don't see, you will look good...)

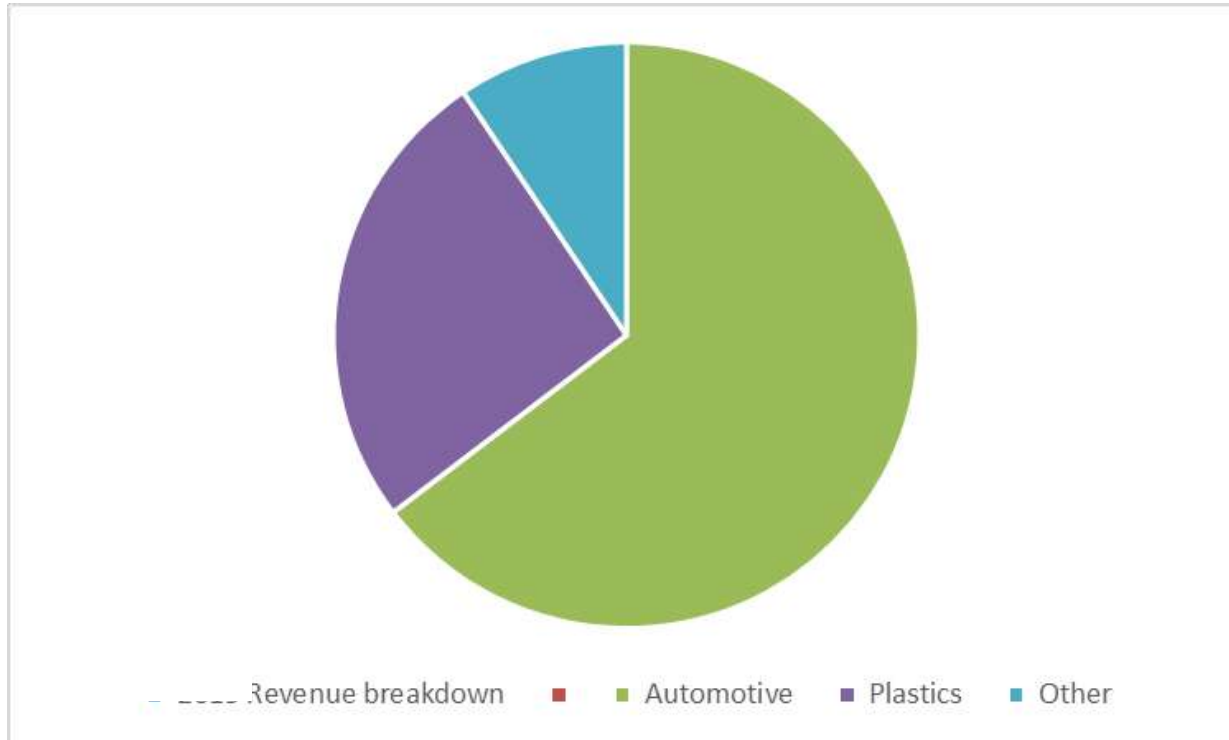


Various charts could be provided

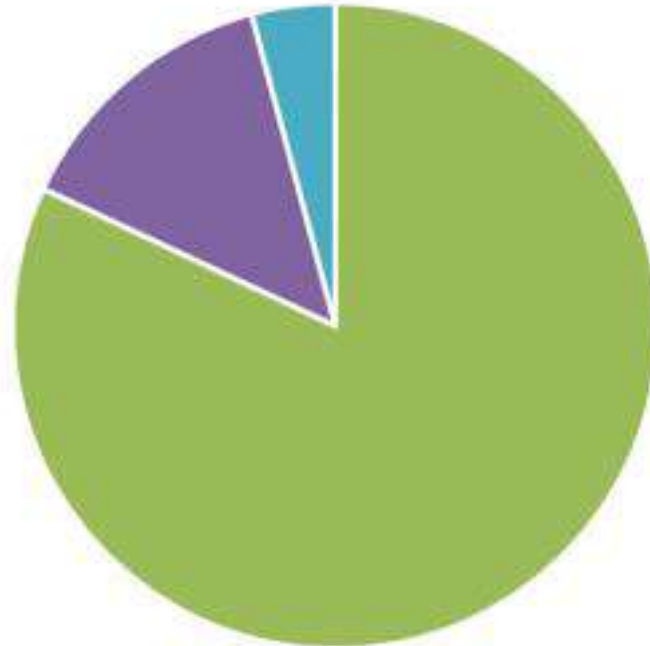
Revenue by month



Segment selling to



Geography



2020 Revenue breakdown

- Canada
- U.S.
- Other



Expenses



Direct costs

- Largest expense on the statement, has three key parts
- They should be broken out
- Sub-contracts, parts and labour



Other changes

- The expense captions are not that useful
- Rent would normally be included in General Administration
- Miscellaneous expense is much too large a % of total expenses - the major components should be broken out



Expense explanation

- The large increase in professional fees, reported under General Administration was due to the receipt of an unexpectedly large bill from the firm's lawyers, with respect to the Rio Properties dispute
- This should have been explained



EBITDA

- There might be value in presenting this number



EBITDA

- **Earnings Before I Tricked The Dumb Auditors**

Must be an accountant!





EBITDA

- **Earnings Before Interest Taxes Depreciation & Amortization**
- What really happened in the business, let's exclude non-cash and non-operating amounts

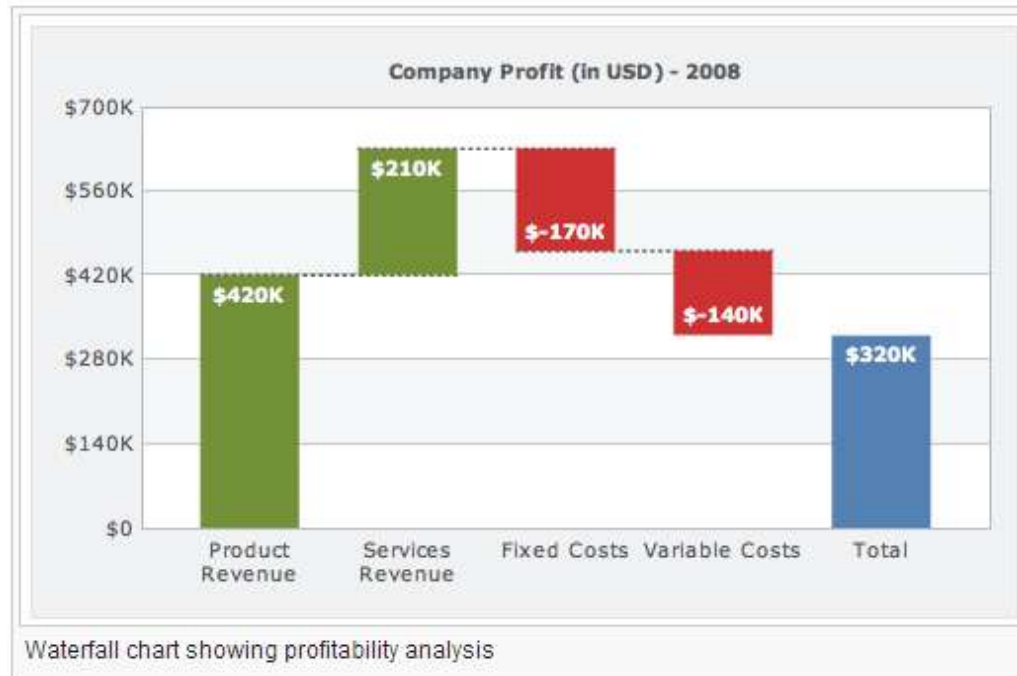


Budgeting

		Budget	Variance
	<u>September</u>	<u>September</u>	<u>Fav/(Unfav)</u>
Revenues	1,828,632	1,611,667	216,965
Direct project costs	<u>1,444,619</u>	<u>1,256,028</u>	(188,591)
Margin	<u>384,013</u>	<u>355,638</u>	28,374
	21.0%	22.1%	
<u>Other costs</u>			
Sales & marketing variable	51,072	57,825	6,754
Sales & marketing fixed	64,445	64,918	472

- The Budget versus actual variances in the current monthly financials are positive when revenues exceeded budget, but also positive when expenses are above budget
- This should probably be changed to the normal way of presenting, i.e. expenses above budget result in a negative variance, because they are bad news. The caption should state favourable/(unfavourable)
- Percentages could be shown
- (Some people use waterfall graphs to present budget versus actual)
- Budget amounts for both month and year to date should be presented

Waterfall graph





Budgeting

- The Budget versus actual variances in the current monthly financials are positive when revenues exceeded budget, but also positive when expenses are above budget
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- Percentages could be shown
- (Some people use waterfall graphs to present budget versus actual)
- Budget amounts for both month and year to date should be presented



A different way of budgeting

- The Budget variation for direct project costs budgeted as a \$ amount does not have much meaning, because most of the variation is due to the variation in sales
- It might be more meaningful for the budget amount to be a % rather than fixed, so that this is a flexible budget

More budgeting

- Flexible budget – one government accountant at the seminar said “I don’t understand flexible budgets, I thought it meant that at the end of the year, you force spending to equal budget”
- One live attendee asked if we could flex the lunch longer to 2 hours!





More budgeting

- The Budget probably needs revision, because of the huge C200 contract that was not anticipated in the Budget - otherwise the budget versus actual deltas will be large
- The Budget appears to be a flat monthly amount, this is likely not appropriate given the seasonality of the business, a more accurate budgeting process should be used
- Interest expense in the month is quite a bit under the budget, this needs to be explained



Balance sheet



Balance sheet

- Budget balance sheet information could also be provided, as well as balance sheet forecast information



Interesting balance sheet idea

- I always mentally calculate current assets less current liabilities (working capital), when I see a balance sheet
- For monthly financials, the format is flexible
- We know of a company that reports net working capital first on the balance sheet (current assets minus current liabilities)
- This is useful information for users



GAAP issue

- A Statement of Cash Flows has not been presented
- This is required by the CPA Handbook Section 1400.11 and moreover is useful to users, reconciling opening and closing cash
- They often don't balance for me!

Actual cash



- Cash is king they say
- Some forward-looking cash information should be included
- The unused amount on the line should be disclosed



Reflection

- One topic in any internal financial reporting is how much subsequent info should be disclosed in the narrative, considering the management implications, not the GAAP rules
- If it is very material, it should definitely be disclosed, rather than waiting for the following month
- Cash put in escrow is material, not a Type I subsequent event to be booked in the month, so probably best to disclose



Receivables

Accounts receivable	\$ 52,904
Allowance for Doubtful Accounts	(\$13,000)
	<u>\$ 39,904</u>

- It would be possible to report the trade A/R and holdbacks separately
- The could disclose the actual allowance for doubtful accounts
- Information on receivables and holdbacks could be segregated between complete and incomplete projects, there is no collection leverage available on the latter – an important difference
- The old Hobo Corp receivable should be discussed, it sticks out as very overdue, although not that large



Receivables

- There appears to be a difference between the A/R subledger and the G/L - the subledger is \$23,133 higher - this should be investigated
- Work in process and other receivables are very different assets and should be separated in the balance sheet
- The company could actually report a roll forward of receivables, which at least accountants would get a lot out of (also inventory/WIP)

Roll forwards – (not this company)

Opening inventory	\$ 14,322,323
Purchases and production costs	21,313,434
Write downs	- 430,000
Cost of sales	<u>1,604,829</u>
Closing inventory	<u>\$36,810,586</u>

Opening A/R	\$ 1,452,904
Sales	1,397,389
Collections	- 1,033,044
Closing A/R	<u>\$ 1,817,249</u>

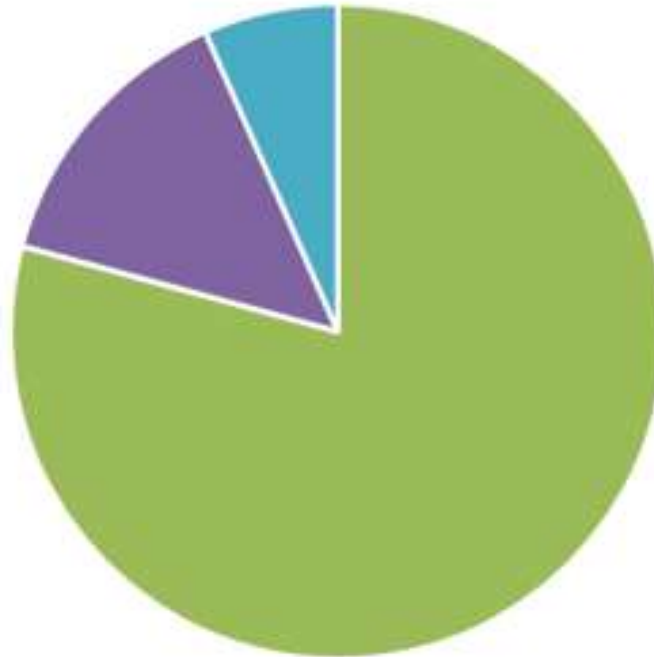


Various charts could be provided

- A/R currency
- A/R by industry
- A/R by geography



A/R by currency



■ A/R by currency @ Sept 30/ 2020 ■ Canadian ■ U.S. ■ Other



New line on the balance sheet

- During the month, the company acquired a patent, related to a useful concrete construction technology and it is reported as an intangible asset in the balance sheet
- This should have been explained to the users, including the business reason for the purchase and the amortization policy, which is shorter than the legal life of the patent is 20 years
- (This is the correct accounting, it is the lesser of the legal or the useful life)



A note that might be useful

- I once reported share activity monthly (opening, sales, options exercised, redemptions, closing)
- Like a GAAP year end note
- It was very well received

I also reported Earnings Per Share, unheard of and not required for a private company, but the main shareholder and investors and employees loved it - how much money did my 3,000 share earn...

- I recently thought of an additional possible reporting item in this vein, Executive salaries per share!

Selling shares means the company has been valued, how?



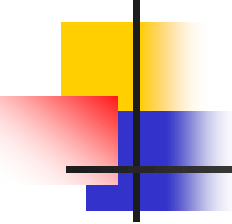
What is your company worth?

- Here is a valuation metric, that is surprisingly good
- For private businesses, that aren't growing, about ____revenues



What is your company worth?

- Here is a valuation metric, that is surprisingly good
- For private businesses, that aren't growing, about .75 revenues



This case is not technical
GAAP, but...



Possible GAAP departures

- The Wayly contract which is over budget should be checked to see if the loss for the entire contract should be booked, as required by ASPE
- It is possible that stock-based compensation accounting, Section 3870 must be applied because of shares sold to employees, depending on how the arrangement works
- The accounting for the share redemptions should be verified. It is only correct if the departing employee paid \$10 each for the shares, because there has been no change in retained earnings related to a premium



Possible GAAP departures

- Under ASPE, the taxes payable method may be used with no owner consent, it seems that this is the method that has been used
- However, with significant temporary differences potentially arising from construction holdbacks, not using the future income tax method, might distort the financials.



Possible GAAP departures

- A statement of Retained Earnings has also not been presented
- The company has taken a non-refundable deposit into income
- This is not consistent with % completion accounting – the stated accounting policy
- Although there might be an economic argument that the deposit is fully earned, because under no condition will it ever be paid, GAAP does not permit this



Note

- Note, you have to remember all this for this quiz



Comment

- Don't be stressed if you didn't think of all these things when you reviewed the case
- There are more....



Do you see any process
issues?

Do you see any process issues?



- Monthly financial statement review procedures should be put in place to find out exactly why the amortization error took place and to ensure that it does not happen again.
- It took the Accounting Manager 23 total days to report the month end results
- Steps should be taken to analyze closing procedures and improve the turnaround and carry out a faster close, so that better decisions can be made from more timely information



Note

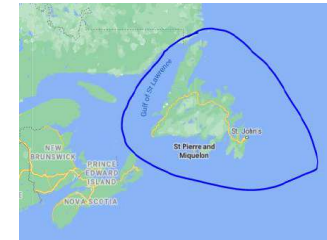
- Fast close tips are in the **Practical Tips for Controllers & CFOs** course



Prior month's error

- What should be done about the prior months' error?
- Have you ever made a monthly error you had to correct?
- If immaterial, could flush through this month, with or without disclosure
- The error is material relative to the excess of revenue over expenditure, but is arguably barely material relative to 1% of monthly revenues
- It is not cash (and won't put bank covenants off-side)

Prior month's error



- If material must re-state the prior period under GAAP requirements (Section 1506)
- I would prefer that – the skeleton in the closet belongs to the predecessor
- Someone in one seminar said: hold off and correct at year end
- But this is borderline unethical, you know about it
- One accountant said that in Newfoundland, all errors go through Miscellaneous Expense!
- It would be appropriate to inform the Board and executive immediately about it
- If comparative monthly financials are presented, September should probably be adjusted, in the spirit of Section 1506 of the CPA Handbook.



Interesting

- Just before the merger, the Ontario Institute of CAs had to correct an accounting error of a prior period, in the organization's audited financials – they had to be re-issued!
- I don't think the media picked up on this...



Industry comparative information

- Boards love useful comparative industry performance information
- It is easier to find comparatives for some businesses than others
- Where can you find them?

“Industry” comparatives are important

- To give context
- How about this?
- Deaths Feb-October 2020

COVID-19	10,000
----------	--------

“Industry” comparatives are important

- To give context
- How about this?
- Deaths Feb-October 2020

COVID-19	10,000
Cancer	53,333
Heart related	44,667
Accidents	8,667
Flu	6,000
Suicide	2,667
Other	<u>84,667</u>
	<u>210,000</u>



Sources of comparatives

- Google searches
- Benchmarking studies (may have to pay), some accounting firms have them (PWC)
- Public companies (www.sedar.com and www.sec.gov/edgar.shtml sites are useful)
- Industry trade associations
- Available government statistics (Statistics Canada, Industry Canada, Department of Finance, provincial governments) (accuracy!)
- Exchange data with similar but not competing private companies



Industry comparatives - Agrifood

- I know that **Canadian Association of Agri-Retailers** members regularly upload detailed statistics and benchmarks, which are averaged and shared with all members



Sources of comparatives

- Dun & Bradstreet (know your NAICS code, formerly SIC)
- www.fintel.us Financial Intelligence for Business
- Gartner Group or Forrester Research
- www.hoovers.com
- nielsen.com may have some info
- Your bank
- Companies who approach you to offer themselves for sale



Sources of comparatives

- Private sellers of industry benchmarking information
 - www.Firstresearch.com
 - www.Researchandmarkets.com
 - www.anythingresearch.com
 - www.profitcents.com

Can you think of others?



Statistics

- Statistical analysis may be useful in reporting, I have done it
- For example, the variance of a series of numbers or the standard deviation, compared over time can be quite informative but would have to be explained to users who don't understand statistics
- Eg Standard deviation of monthly revenues

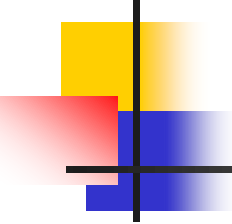
$$\sigma = \sqrt{\frac{1}{N} \sum_{i=1}^N (x_i - \mu)^2}$$

standard deviation for
population



What about some other KPIs?

- Many other key, non-GAAP, indicators concerning the organization could also be gathered and reported periodically
- Some would be appropriate as monthly information at a board level.
- Some are more management level and could even be presented weekly as special indicators in a one-page dashboard report



Try to think of useful KPIs that go beyond the financials

- Key Performance Indicators, also could be called the Vitals Signs or the Metrics, or whatever you want...
- They don't just come from the G/L!
- They tell a lot more with good comparatives, which also could be 12 month rolling in some cases



Most important KPIs

- Average over/under on jobs (most important) – budget & schedule
- Project backlog (broken down by age, industry, geography)
- Jobs being bid on, weighted, the pipeline



Most important KPIs

- Pipeline conversion ratio (even by sales rep')
- Lost bids
- Average bid price miss (if known)
- Business capacity use
- Billings
- Contract signings in the month
- Book to bill ratio (contract signings/revenue recognized)



Your job security would be best measured at this company by

- Backlog and pipeline



More KPIs

- Person hours worked
- Revenue per employee
- Gross profit/payroll (labour efficiency)
- Overtime hours worked
- Employees, opening, adds, departures, closing
- Employee morale



More KPIs

- On the job injuries
- Lost time due to injuries
- # jobs in progress
- Project risks & upsides
- Warranty claims (contractual)
- Warranty claims (goodwill)
- Key subcontractor info
- Idle assets
- Customer satisfaction/work quality



More KPIs

- Days sales outstanding
- Market share
- Website statistics
- Media mentions
- Average project size
- Debt service ratio



Invent a new KPI

- Contract win ratio
- Contracts signed in the period/sales & marketing costs
- Measures the payback from sales & marketing activities
- Could lag it
- Need to use contracts signed, not revenues



Note

- Looking good at work by inventing and creating new, valuable business KPIs is covered in the course **Practical Tips for Controllers & CFOs, in more depth**, including how to invent new ones



Ratios

- A financial executive should try to think of useful ratios that will help management in analyzing the organization



Ratios

- Consideration could be given to reporting standard ratios such as return on sales, return on equity, return on assets, etc. if they would be useful to the company
- Some companies like to use some of the new ratios, such as the Dupont ratios (variations on the traditional ROA, ROE ratios)
- If you start presenting these, they should be fully explained, and probably should not be done monthly, they should be done for a full fiscal year, or rolling 12 months, a month is too short a period



Note

- You should always be thinking of business/advisory comments when you are doing your work, even it is primarily financial reporting
- The bank covenant issue is the biggest one
- The company may have room, based on the balance sheet and the equity amount, for some additional long-term debt



Conclusion

- Reporting can always be improved
- Don't get stressed trying to dramatically improve your reporting immediately, do it over time, consulting users
- You will get a detailed handout with the completed slides on this, including a revised reporting package



Bonus tip



Annual report for private co?

- A bit like a public company
- Impresses: shareholders bankers
potential investors
- Even give to possible customers
(remember NDA)
- No legally required disclosures other than f/s
- How to do it at low cost



Business Plan

- Management bios focus on accomplishments rather than straight data
- Consider public company MD&As
- Carefully track who you give them to
- Get fresh eyes to look at them
- Rehearse the related pitch in front of a critical audience



Banking



The short-term loan

Parking?



Banking

- Who has one of these?



Banking

- The bank robbery I was involved in





Banking

- The bank robbery I was involved in
- I get robbed by a bank...
- The loan problem
- My fiancée's surname was "Lien"!



Banking experience

- I have dealt with all the major banks in Canada at different times
- Accounts, loans, letters of credit
- With one start up I increased the operating facility 10 fold in 4 years
- I used to teach the CPA “canned”
Corporate Treasury Management course

I had a 30 year veteran banker review this, no longer in banking so he could speak his mind, see green comments

Rather theoretical, and people liked my extra stories better...





Bank negotiating tips

- Use good business logic to respond to the bank's unreasonable terms
- Think of a range of alternatives to what the bank is proposing from ideal to not so ideal
- Remember they are always trying to reduce their risks and exposures

Ask them for the rationale



Will they negotiate terms?

Actual Big Five Bank email to me



- *"If you have a suggestion to amend wording you may provide it, however any change will require legal review"*

Smaller businesses will find it harder to get the bank to negotiate terms and move away from standard bank agreements, and often the account managers have less experience and want to stick with the template



Remember banks focus on the
two Cs

- **Collateral and Cash Flow**



Note

- The negotiation principles here apply no matter how small or large your business is, and many apply to all kinds of debt agreements, not just bank facilities
- (Not every company margins A/R)
- I will share some failures in my bank negotiations, maybe you can win the same ones
- “Failure is success if we learn from it”



Bank offer letter - objectives

- Consider adequacy of offer
- Look “outside” the case as well
- (Don’t criticize what you don’t like – how to negotiate to improve it is the issue)
- Increase amount that can be borrowed
- Protect the company
- Protect the shareholders
- Minimize costs
- Loosen covenants & restrictions



Time to read the bank offer

- It's a long read, but all the remaining cases after this are short
- You don't need to read every word, once you understand what a clause is trying to do



Someone said a bank
agreement is like a

- Prenuptial agreement



Finished reading

- Did any one note the banker name joke in the case?
- Shylock, the nasty lender from the Merchant of Venice play by Shakespeare
- Did you notice the special note at the end of the definitions?...



Note

- You “fail” the case if your answer is simply “find a different bank”



Bank case discussion

- Has anyone ever banked with the Northern Bank?
- What is good about the offer?
- Would you sign it?
- (The company probably needs a little more time than 14 days to consider the offer)
- How can this company get more leverage with the bank? Promise family's personal banking/investing business/group RRSP/payroll/get employees to bank there personally

Relationships

- Some people are good at getting results by “schmoozing”
- I am not good at it, and it is not my style
- A story





The offer

- The offer from the Northern Bank (who banks there?) is not a great one, but a number of questions need to be asked and it may be possible to improve on it
- The Northern Bank was reasonable enough not to demand very extensive budget or business plan information before the loan was granted, in this small business context
- So far, the company has not been able to generate an offer from more than one bank, so it is not in a position to leverage other offers



The offer

- If it had very good financial reporting and a strong business plan, it is likely that more offers could have been received.
- Perhaps it would be better to get a longer term for the agreement, but this is a new client for the bank
- If the company can perform well with the Bank for one year, it will have more leverage next year for the renewal
- Legal advice, from a good lawyer, with lots of banking experience should be sought before getting back to the bank.



Big picture – Northern Bank

- Talk to other small business people who have a Northern Bank operating facility – are they happy?
- Are the clauses in this agreement standard Northern Bank clauses or is the bank being hard on you
- The Bank does see growth and they would like to get you signed up now, so they can be your banker if you really grow to become a major client



Big picture – Northern Bank

- Being a newer Schedule B bank, they may be a little more hungry and less risk adverse than the large Schedule A banks
- It would be good if the Bank has experience in your industry



Big picture – Northern Bank

- It might be good to meet with the bank's credit people (usually kept away from customers by banks), they make the key decisions



Is the facility enough?

- The company has been growing at over 200% per year to date
- Is \$250,000 is a large enough operating facility before too long and with the forecast for 2015 sales of \$8 million
- (Some banks use a 10% of revenues rule of thumb for operating lines of credit)
- The problem is the Bank will probably not offer any more to a young, relatively unproven company
- One argument to use with the bank is that if receivables are say \$1M, their operating facility is extremely well-margined



Where else could they get financing?



Small Business Loan program

- Revenues under \$10M
- Up to \$1M

Canada Small Business Financing Program

Find a loan for your small business

This is a loan program in collaboration with financial institutions. If you are looking for other government financial incentives including grants or general information for small businesses, please access the [Canada Business Network](#).



✓ Equipment

✗ Working Capital

✓ Business Vehicles



✗ Inventory

✓ Renovations

✗ Labour

✓ Commercial Property

✗ Advertising



Other possible sources

- Could the shareholders or relatives provide financing?
- Have any non-bank operating facility providers been considered? (some do 85% on A/R)
- Have suppliers been considered as a source of financing?
- Has warehouse equipment vendor financing been considered?
- Has leasing been considered?
- Have any asset-based lenders been approached?



Other possible sources

- Could the company considering factoring receivables (selling them), to provide cash and reduce the need for an operating facility?
- Has EDC (Export Development Corporation) been approached about helping this company which exports and working with the Northern Bank





EDC help

- Loan guarantees
- BDC co-lending
- Advance payment insurance
- Foreign exchange facility guarantee
- Performance security guarantee
- Credit insurance, to be discussed soon



EDC told me recently

- “We find HSBC and National Bank the best to work with”



Question

- Someone once asked: how could one get another lender to rank equal with the bank?
- Answer: rare, bank must agree, and they always want to go first
- That is there would be security interest issues versus the bank's General Security Agreement if another lender had a security interest

What clauses are “hills to die on”?





Most participants want to first discuss

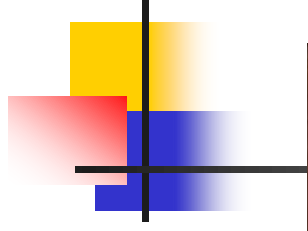
- Personal guarantees



The clause

- (c) Joint and several personal guarantees of both principals include security interests in their principal residences. The principal's spouses will be required to get independent legal advice with respect to the principal residences.

My first ever experience with personal guarantees



Personal guarantees

- Polling question

Are there personal guarantees with
your bank facilities?



■ Yes ■ No

Personal guarantees



- The personal guarantees required of the founders, including a security interest in their principle residences, are likely very objectionable (they are legal)
- The personal guarantees also require the involvement of their spouses and the complication and cost of independent legal advice
- The bank wants them to reduce risk, and ensure the business owners have some “skin in the game”.



The approach

- Reduce or soften them any way possible
- Time them out if possible
- You should do the same for any similar requirements, from any bank, even if not personal guarantees



The clause

- (Interestingly, the bank has not asked for personal net worth statements)

Offering them might help guarantee negotiations



First question

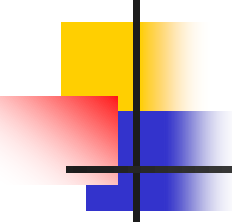
- Ask the bank, what they would like in order to remove the personal guarantees?



Negotiation strategies

- Ask what size the facility would be without the personal guarantees, this finds out their “value”
- If inventory could be margined instead of A/R, could they be dropped entirely?
- A limited personal guarantee by each guarantor, not joint & several

A real life example, I have seen



- Bank wants \$500K guarantee joint & several guarantee from all 4 guarantors
- If the guarantee is triggered, the bank will likely go after the richest/debt free guarantor
- Much better:
- Each guarantor signs a \$125K guarantee, \$500K is not joint & several

Negotiation strategie



- A limitation against the principal residences, don't include them
- Provide some other collateral, say some personal investments, and exclude the principal residence
- A limitation against property owned jointly with the spouse
- Reduced guarantees in return for a family compensation cap



Negotiation strategies

- The Bank agreeing to drop the guarantee after a year
- The Bank agreeing to “consider” dropping the guarantee after a year (weaker)



Negotiation strategies

- The Bank agreeing to drop the guarantee once the company has a certain level of equity in the business, for example \$900,000 (worked for my brothers once)
- Covenant trade-off with the bank versus personal guarantee change



Negotiation strat

The milestone approach - banks are often leary of this after a court case said if a client achieves part of the milestone the guarantee should be proportionately reduced..

- The Bank agreeing to drop the guarantee once the company has a certain level of equity in the business, for example \$900,000 (worked for my brothers once)
- Covenant trade-off with the bank versus personal guarantee change



Notes on guarantees

- If there are outside investors with say 40%, some banks won't ask for personal guarantees of the 60% shareholder as it would be unfair
- If you are with a sub of a big foreign company, the issues may be quite different if you can get a parent company guarantee, it takes away a lot of the difficulties



Notes on guarantees

- A good tip on how to avoid intercompany guarantees is found in the **Practical Tips for Controllers & CFOs** course, as well as quite a few other bank relationship tips



Jemand sagte

- Wenn sie meinen Erstgeborenen füttern und sich um sie kümmern, könnte das funktionieren...

Someone said

- If they feed my firstborn and take care of them, this might work....
- Someone else was shocked that the bank would ask for cash in paper bags...





Let's look at bank outs



Bank outs

- The Bank offer says it “may cancel or restrict availability of any unutilized portion of this facility at any time and from time to time without notice or demand”
- It would be preferable to get a committed facility, but difficult, given the company is a new client, with no track record
- Perhaps it could be negotiated as committed, with higher fees, the bank must make room in its capital structure in this case

The bank can pull the plug when



- *"There is, in the sole opinion of the Bank, a major undesirable development in the financial condition, operation or ownership of the Borrower"*

The bank can pull the plug when



- *"There is, in the sole opinion of the Bank, a major undesirable development in the financial condition, operation or ownership of the Borrower"*
More commonly worded
- *"There is, in the sole opinion of the Bank, a **material adverse change** in the financial condition, operation or ownership of the Borrower"*



Analysis

- Essentially this means that if they don't like something, they can pull the plug on the Term Loan and demand payment and the company could not really question the grounds for the judgement of major undesirable developments



Analysis

- RI should argue vehemently against this clause, telling the Bank, they already have lots of “outs”
- The bank might also want to shut down the loan, because of its own ratios, or its economists are pessimistic about the sector
- Some Canadian banks says the “material adverse chance” (MAC) clause is non-negotiable, but I know strong companies who have negotiated out of it

Banker has seen “acting reasonably” inserted to soften a MAC clause



Note

- A company apparently won an action against a bank for unfairly calling loans based on a MAC case
- But it took years and years, and the business was already destroyed



Events of default

- If there is an event of default under the agreement, the facility must be repaid
- There is no provision for getting out of default
- This should be provided for, or it is not fair, perhaps 10 days, 20 days, 30 days (a bit like a breach cure clause)
- For example, the company is in default for not having the life insurance
- Based on the offer, they can't get out of default, by getting the life insurance



More events of default

- The offer says that the entire facility is in default if “the Borrower defaults in the payment of any indebtedness to any Person”
- This might mean a technical default on a minor obligation to a supplier of \$10 (you forget to pay them) might collapse the whole banking agreement
- Perhaps a dollar limit should be provided, over \$40,000 for example
- In practice banks may not exercise this, but if it is there, they have an option



Covenants

- Some bank clients have no covenants, this is a nice position to be in
- Have you seen any unusual covenants ?
- It is important that the proposed covenants be examined to see if they are reasonable and maintainable - they need to be stress-tested which means projecting balance sheets
- A ball park calculation of the company's year end net worth is \$600,000 plus \$180,000 profit, less \$40,000 in dividends, giving approximate net worth of \$740,000, better than the covenant minimum of \$700K but close



Covenants

- You should ask your network if they know how “patient” the Northern Bank tends to be in this city, with clients who violate covenants
- Do they “pull the plug” immediately, or do they work customers?
- If covenants are violated, RI could find itself needing to repay the Operating Facility and/or the three year term loan on demand, without the funds to do so and facing a real crisis



Covenants - evaluation

- From a general banking perspective, the covenants are not too unreasonable
- A 1.75 to 1 current ratio would be more common than 1.8, a rather odd number
- Some banks will exclude their debt from the current ratio calculation – ask for this
- You might want to try to argue deferred revenue is not a real liability and should be excluded
- (Same with Asset Restoration or any other liabilities that are not like trade payables...)

Also deferred/future income taxes



Current ratio covenant survey

- What is your current ratio covenant?
- All seminars: 1.38
- A mix of companies and credit risks



Net worth covenant

- The Bank's net worth calculation, does not include, as "equity", related party indebtedness that has been postponed or subordinated, to the Bank's satisfaction
- Since the bank "controls" these liabilities, in effect they are equity
- If the bank would accept them as equity, or exclude them from debt, this would help the company's position relative to the covenant
- It might be possible to actually ___ some shareholder loans to equity, to help the net worth calculation



Net worth covenant

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- Since the bank "controls" these liabilities, in effect they are equity
- If the bank would accept them as equity, or exclude them from debt, this would help the company's position relative to the covenant
- It might be possible to actually convert some shareholder loans to equity, to help the net worth calculation



Intangible definition

- Since RI has some software licenses on the balance sheet, you may want to find out if they are considered intangibles by the Bank
- They arguably don't have "physical substance", but they aren't mentioned specifically in the offer letter
- One approach is not to ask, since they are not specifically excluded
- The other approach is to get clarification now



Experience

- I once got a major bank to agree not to exclude prepaid software licenses from intangibles
- After I left the company, they changed their mind
- I was able to dig up the old email and help my successor CFO push back on this



Covenants & estate planning

- The founders have started some estate planning steps
- Estate planning often includes the issue of high-low preferred shares (redeemable and retractable at a price that far exceeds the issue amount, to fix their value for income tax purposes)
- Under ASPE, it is possible, they can be reported as shares, with the proper disclosure, Section 3856.23
- You might want to discuss this with the Bank now
- Exclusion from debt under the terms of the covenant definition would be reasonable
- The Bank might insist on a retraction veto right.
- (Some banks don't mind these activities for tax planning purposes, even temporarily waiving covenants.)



Negotiating covenants

- I once decided that it was illogical for a Big Five bank to flex the facility up or down with A/R and inventory, but with the net worth covenant it was “all or nothing”
- So I asked the bank to flex the facility with the level of tangible net worth
- A new account manager said I support that idea, I will go and check with my colleagues
- The colleagues said no.....



Another covenant note

- A “covenant cure” clause would help protect RI. It could state that upon violation of any covenants, the company has 30 or 60 days to “cure” the violation, before the bank can take any action
- The Bank wants to test this covenant monthly
- If you could get them to move it the test to quarterly or even annually, this would be better



Possible debt service covenant

- The actual details of this Bank's version of a debt service covenant should be obtained
- Some projections should be done to measure estimated future compliance
- The covenant would likely involve dividing income or cashflow before debt service obligations with debt service obligations
- Key point – monthly income statement covenants are risky, because they can be violated with a single bad month, or a bad season



Possible debt service covenant

- The company usually won't blow a balance sheet covenant with one or two bad months, it takes longer term deterioration
- A rolling test would be better than monthly, that includes several months or quarters or even a full year, because it would smooth variations



Let's look at the actual loans



Term loan - term



Term loan - term

- A longer loan term should be preferred, perhaps approaching the useful life of the equipment
- The term loan payment including principal will actually decline over time, they are not flat payments (like most mortgages) which is easier for budgeting

Operation of facility



- If the company's account is negative two dollars, a \$10K loan is advanced
- The facility would be slightly cheaper if the revolving was in multiples of \$5K, \$1K or even nothing, rather than \$10K
- I had my bank go from \$5K to \$10K at renewal, and I complained and they went back to \$5K



Let's talk about margining

- Which impacts what we can borrow day-to-day

Let's talk about margining

	Raleigh Import-Export Inc.						
	31-Oct-20						
	Accounts Receivable						
	<u>Current</u>	<u>1-30</u>	<u>31 - 60</u>	<u>61 - 90</u>	<u>> 90</u>	<u>TOTAL</u>	<u>Terms</u>
9226-2674 Canada Inc	\$ 13,000.00	-	-	-	-	\$ 13,000.00	Net 30
Advantekss Inc.	63,126.76	-	-	-	-	63,126.76	Net 30
Health Limited	22,100.00	13,000.00	13,000.00		-	48,100.00	Net 30
Enron Corporation					8,053.54	8,053.54	Net 30
Walmart Canada					184,503.22	184,503.22	Net 60
Bell Canada Inc.	18,767.37	8,053.54			15.00	26,835.91	Net 60
Sweden Import AB	51,004.80	51,004.80			-	102,009.60	Net 30
Justin Trudeau Inc.	71,347.96				-	71,347.96	Net 45
Christopher Corp	63,126.76	63,126.76	63,126.76	-	-	189,380.28	Net 30
SellingStuff.com	22,489.71	-	86,053.54	-	-	108,543.25	Net 30
	<u>\$ 324,963.36</u>	<u>\$ 135,185.10</u>	<u>\$ 162,180.30</u>	<u>\$ -</u>	<u>\$ 192,571.76</u>	<u>\$ 814,900.52</u>	



Margining

- The Bank does not appear willing to margin any of the company's inventory
- It is common for inventory to be marginable in a bank agreement with receivables, at 50%, although I have got 25% on volatile computer chips
- (If the Bank is only willing to provide a \$250,000 operating facility, the receivables alone may support it)

Banks are less comfortable with inventory and sometimes will limit it to 25% of borrowing base

Side notes



- I have tried to get a bank to base the margin on selling price of inventory, not cost (98% margin on software DVDs) but they refused
- Some companies are able to margin Work in Progress and accrued receivables under certain conditions – always negotiate
- Inventory can usually be margined at 90% if EDC insured for export

Foreign receivables



- Since the company sometimes sells to Spain and Portugal, the exclusion of these countries may cause a problem
- This should be discussed with the Bank
- It is possible that certain laws in these countries mean that the Bank excludes them
- (One of my Canadian bank's would margin Swedish receivables but not German)
- Could the bank margin them at say some low %, say 25-50%?



Foreign receivables

- It may be necessary to get EDC (Export Development Corporation) foreign receivable credit insurance, which is generally in the 40 to 60 basis points range for approved companies (0.4% to 0.6%)
- The result is 90% insurance coverage (10% deductible if there are losses) and 90% bank margining of any insured receivables, Canadian or foreign, any age



Foreign receivables

- This also gives you high quality free credit checking, better than most companies can do themselves
- If EDC turns the customer down, it is an indication of real credit concern usually
- EDC's credit insurance services are very user-friendly and are web-based
- Credit insurance is also available from some private sources - a broker can help select the best source
- EDC can insure Canadian receivables with a partner



Let's go back to the A/R list

	Raleigh Import-Export Inc.						
	31-Mar-2021						
	Accounts receivable						
	<u>Current</u>	<u>1-30</u>	<u>31 - 60</u>	<u>61 - 90</u>	<u>> 90</u>	<u>TOTAL</u>	<u>Terms</u>
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Margining mechanics

- Excluding receivables 90 days after invoicing, when some customers may be strong and are on 60 day terms does not make sense
- When 31 days late, these receivable are not marginable, whereas a net 30 receivable is marginable when 59 days late
- This is a standard policy the Bank may be unwilling to change



More mechanics

- If \$1,000 is disputed or late with a good account, nothing is marginable
- A compromise might be that if less than 10% of the total receivable from a customer is overdue, then the balance is still marginable – I have persuaded a bank to accept this
- The company should also have the ability to persuade that a particular receivable is good, even if it not good by any of the fixed criteria, i.e. it is proven good because the customer paid after month end

Margining mechanics

- In our Newfoundland seminar, a guy said if the bank won't margin a customer's receivable, because of one over 90 day disputed invoice, "just send a new invoice, that's what we do in Newfoundland"
- This is hopefully a joke, it is probably fraud...





More mechanics

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- A compromise might be that if less than 10% of the total receivable from a customer is overdue, then the balance is still marginable – I have persuaded a bank to accept this
- The company should also have the ability to persuade that a particular receivable is good, even if it not good by any of the fixed criteria, i.e. it is proven good because the customer paid after month end



More mechanics

- The bank may be willing to have some “named exclusions” of companies, who they will margin always as they are “blue chip”, even though by the agreement, they could not be margined, eg **Walmart**

If the company has an official credit rating eg Moody's Or S&P, it is easier



Bonus advice, gov't A/R

- Although there are no government receivables in the case, note that banks will often margin older government receivables, because they are a special case, but you may need to ask



Interesting

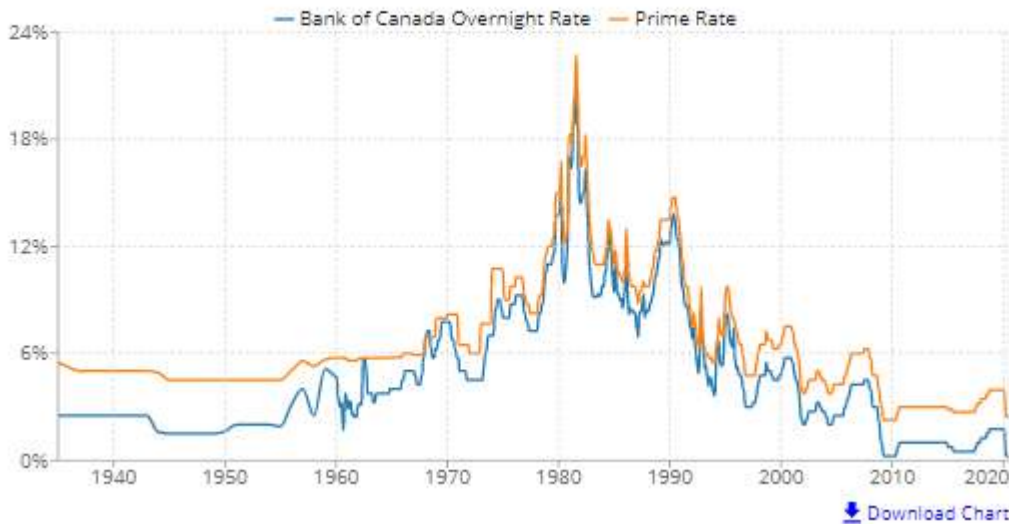
- An American business person told me he once had \$200K on deposit with a bank a \$500K loan and they went bankrupt and he lost his \$200K and still had to pay the \$500K, which annoyed him
- There was no “set-off” clause to protect him in this situation



Interesting

- I asked a big five Canadian bank, if this could happen in Canada
- I didn't get a clear answer...
- Canadian bank reg's are tight, I am not very worried about them failing
- CDIC insurance covers the first \$100K on deposit of course

History of Prime Rates and the Bank of Canada Overnight Rate



ate in

- 22.75% on Wednesday, August 12th



Interest rates

- Who remembers the prime rate in 1981?
- The highest ever in Canada
- 22.75% on Wednesday, August 12th
- Remember the payment impact, 25 year \$300,000 mortgage
- 2% interest - \$1,270
- 11.75% interest - \$3,043
- 20% interest - \$4,845



Interest rates overall

- You need to find out if the bank's prime rate, Canadian and U.S., generally moves with the major bank's' prime rate
- Some historic data should be available from the account manager if you can't google it
- Prime plus 2.5% is a bit high, not that unreasonable for a young business, given the risk
- You should ask them to consider _____ the rate after a year



Interest rate survey

- What is Prime plus ___ on your line of credit?
- All seminars: Prime plus 0.90%
- A mix of companies and credit risks

: prime plus a quarter



Interest rates overall

- You need to find out if the bank's prime rate, Canadian and U.S., generally moves with the major bank's' prime rate
- Some historic data should be available from the account manager if you can't google it
- Prime plus 2.5% is a bit high, not that unreasonable for a young business, given the risk
- You should ask them to consider reducing the rate after a year



Interest rates

- Another alternative is a lower rate on the say the first \$150,000 and a higher rate for the balance of the loans, where they have more risk
- You might be able to negotiate a rate improvement if for example the net worth or current ratio increases to a specified level

For larger borrowers, try to get a built in rate grid, on a Funded/EBITDA grid, lower leverage, lower rate



Interest rate comments

- The term loan has a floating rate
- It is generally better/safer to finance long-term assets with long-term financing at fixed rates
- This adds risk to the financing
- (It is absolutely standard for Operating Facilities to be floating rate)
- Ask the Bank about this, but they may not be interested in changing, or they might give a high fixed rate



An option

- You might be able to lay off the risk by entering into a “fixed-for-floating” interest rate swap, although the floating rate may be LIBOR (London Inter Bank Offering Rate)



An option

- You might be able to lay off the risk by entering into a “fixed-for-floating” interest rate swap, although the floating rate may be LIBOR (London Inter Bank Offering Rate)

What is an interest rate swap?

An interest rate swap is an agreement between two parties to exchange one stream of interest payments for another, over a set period of time. Swaps are derivative contracts and trade over-the-counter.



Other interest rate notes

- You could argue that the rate on U.S. loans should be the same as Canadian, after all the risk is the same.
- You might be able to negotiate a rate improvement if for example the net worth or current ratio increases to a specified level
- Perhaps the bank would go with an interest and or principal holiday on the term loan for a period, but there would be trade off for this.



Interest on late amounts

- The interest rate on late amounts is a rather punitive prime plus 9%
- This should be argued with
- (I have seen prime plus 7% in real agreements)



Bank fees and business stress

- Public co I was Controller of had violated covenants and was in some trouble
- The bank said “we have decided to charge you a \$15K a month, risk fee”
- “Now, we have decided to send a monitor in to check your situation weekly, the monitor will be PWC, oh yes, and you are paying...”
- Our loans were likely now with the “special” loans dept of the bank
- Lesson: open season on fees, if covenants have been violated..



Financial stress

- In April 2020, I created a 2 hour in depth course on the topic **Practical Tips to Get Through a Cash Crisis**
- Deals with the bank squeezing you, covenant violations and many other topics
- Was available through CPA Quebec, live and video course, over 1,500 have already signed up for it

Comments on course

- A useful course jam packed with valuable insights given the ongoing economic environment around us
 - I feel you gave a good cheat sheet to any of the participants to help their companies survive through the current Cash Crisis
 - Good to have practical tips, real life examples – not just for during a pandemic but other times of crisis as well
 - Your seminar was a great review of tools and things available to a company in this difficult cash flow time
 - Well presented, like the questions and instant feedback
 - It was very informative and thought provoking
 - **I was a 30 year Banker, leading corporate lending teams for a big 6 Bank, and found the information very on point and would be useful for people having to deal with their Bank in this environment**
 - For myself personally the accounts payable ranking really stood out - it was helpful to see it laid out the way that you did it
 - I'm gathering my virtual learning kids around to watch this. Better than any other entertainment
 - **It was a good session, slides had good content, you have a personable delivery, this is good stuff (Licensed Insolvency Trustee)**



Bank fees and rates

- What do you think of them?



Fees and costs

- They are hitting you with fees all over the place
- There is an up front fee, as well as a monitoring fee, a renewal fee and the current activity fees
- You are not renewing, you are setting up for the first time
- Perhaps they could make it one fee so it is less confusing
- An estimate of the direct revenue to the Bank under their proposal is nearly \$25K per year.



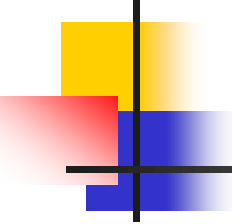
Bank's total return

<u>Total bank fees</u>	
Set-up fee	2,000
Monitoring fee	3,600
Renewal fee	1,500
Activity fees	2,160
Interest	
P+2.5% times \$300K	15,600
	24,860



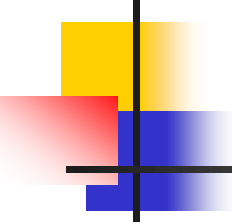
Activity fees

- The Bank wants to have the right to increase its activity fees at any time
- This is not desirable
- They should at least hold them for the term of the agreement
- Alternately, they should only move when the bank moves them for all its customers



What is the “hidden cost” in the agreement?

What is the “hidden cost” in the agreement?



- Your company will have to bear the legal costs
- Taking security interests costs involves some legal work
- You don't want these to be too high
- Ask the Bank what the estimated legal fees including out of pocket costs are and which law firm they propose to use, or are they using in house Bank lawyers?
- Have the Bank ask for a quote from the law firm that they pass to you before starting
- If the proposed law firm is an expensive, consider trying to get the Bank to use a cheaper one



Other negotiation ideas

- Veto rights on which law firm would be also be a better clause
- Even better, try to get the fees capped
- We have heard of banks being willing to use client's lawyer
- Ask to see the actual legal bills and be prepared to question the charges



Don't worry

- If you didn't get all these bank negotiation ideas when you read this case....



Bank reporting

- Bankers are not strong on accounting – a story
- The Bank is several years out of date, the term deferred taxes no longer exist under Canadian Generally Accepted Accounting Principles
- Should get the Bank to change this to future income taxes, for greater clarity
- However, unless the company has larger future income debits than credits, this will help the current ratio covenant



Bank reporting - timing

- The Bank may be asking for financials too soon after year end, at 60 days
- You are still getting consistent reporting in place
- The auditors will be busy with their bigger clients in January and February
- Talk to the Bank about this and ask for 90 days
- It would be simpler if all Bank documents were due 30 days after month end rather than 20, including the financials, which the company has some difficulty in producing on timely basis at this point in time



The demand for an audit

- The Bank has asked for audited financials, perhaps because the company is a new client
- (Tell them no problem, as long as you pay for it...)
- A first audit will likely be messy and costly, the company has never had an audit before
- However, the shareholders will benefit from greater assurance on the financials, but this is a small business, they know the business well



Audit pushbacks

- Often in small business, the Bank will accept a Review Engagement only Under \$5M credit facility usually
- Consider asking the Bank to drop the requirement to a Review Engagement Report instead
- Or at least drop to a Review after the first year, if all goes well
- Another cheaper compromise position is to have the accountants do a Review and a report on performance of “specified procedures” on accounts receivable (and inventory if necessary)
- This would likely be cheaper than even a review, but would have to be approved by the Bank



Audit pushbacks

- Another possibility is “specified procedures” only, but it would not give the Bank any assurance on the financials as a whole, so they would be unlikely to agree
- The ideal would just a Notice to Reader or acceptance of management’s statements



Since we were talking about auditing

- We need an audit junior joke



Jokes on audit juniors

- Junior finds that the audit senior is on the company payroll in the company payroll ledger they are given to audit (fake!)
- Junior is told that “the client does this to get a more favourable audit”
- Junior is shocked!

Another auditor joke

- The fraudulent expense claim..





Other reporting notes

- I have heard of a bank that would double the facility if the financials were audited
- How many people have seen the bank asking for a copy of the auditor's management letter – it might not be good for them to see this



Since we are talking about banks

- A story...



Auditing a Big Five bank

- I am on the joint audit with another big accounting firm
- My big moment in auditing, I found a \$50 million error
- Conclusion, immaterial, pass...
- Reason, balance sheet only
- (I never felt I fully understood the areas I was auditing...)



Veto rights - dividends

- The Bank proposes veto rights on: dividends, repayments of shareholder loans and changes in ownership
- The latter could restrict estate planning flexibility
- You can always take out shareholder remuneration in the form of salary or management fees, without the Bank having veto rights
- However, this has different tax consequences and you would rather have complete flexibility



Key counter-argument



Key counter-argument

- You should argue that if the covenants, particularly net worth, are on side, the bank should not worry about restricting dividends, this covenant controls excessive dividends

With a good relationship and advance discussions and trust in client's financial info, hopefully they won't restrict dividends even with an approval clause



Other arguments

- You promise to give the bank notice of dividends
- Dividends could be paid if say an equal amount was repaid on the loan facility
- A fall back position would that dividends more than \$X (historical average perhaps) need approval of the Bank
- Another option is they need approval of the bank but “such approval not to be unreasonably withheld”
- This last clause would give the Bank some pause in vetoing dividends on a whim, it softens the clause



Other arguments

- (Note: A “such approval not to be unreasonably withheld” clause is a good compromise, any time bank permission is required)
- Another compromise would be a total remuneration (all types) veto, with a lot of flexibility



Note the approach

- Each time I provide a range of options, some a lot better for the borrower, some just a little better...



Budget

- The Bank requires an annual budget including balance sheets, income statements and cashflows
- It will be good discipline to prepare a budget
- This should be useful to the company otherwise and hopefully not too onerous once good reporting is in place
- Bank interest expense will need to be in the budgeted now



Credit card

- The shareholder card should probably be dropped
- A credit card facility should be requested with the Northern Bank, that is company debt, rather than personal debt
- The Bank might be able to help, by carving an amount out of the credit facilities
- If not, other credit card companies could be approached for a corporate card or get a prepaid credit card

Side note on corporate credit cards



- It can sometimes be surprisingly difficult to get a corporate credit card
- (Contrast this with weekly offers in the mail for personal credit cards.)
- A CPA with a 1,000 person US public company said she was told to put an equal amount on deposit, to have a corporate credit card
- Perhaps a company can disappear more easily than a person, and there is limited liability

Side note on corporate credit cards



- I was once unable to cash secure a \$10K corporate credit card with a large Canadian bank
- I was told once, bring your billionaire owner in from Europe to the branch to sign the credit card papers!



Life insurance

- You will need to ensure that the founders get the life insurance because otherwise the facility could become null and void
- Quotes should be obtained immediately to determine the cost so that it can be considered and budgeted
- The cost should not be that high given the age of the founders, if they are in good health
- I have heard of bank life insurance that fluctuates with the changes in the total bank debt, so that the cost was lower



Interest on funds on deposit

- The interest rate for funds on deposit is only .03% per annum
- This should be negotiated
- It would be easier to negotiate this with some comparable numbers from other banks



Other points

- It would be better to divide the types of breaches or events of default into major and minor, the latter not resulting in the loan being called, but with smaller ramifications
- Give the company has some foreign sales, the company should negotiate some foreign exchange facilities (EDC can help)
- If the company faces longer term foreign currency risks, it might want to enter into forward contracts to buy or sell currency for hedging purposes, and these have banking implications



Other points

- The source deductions portion of the statutory prior claims should have no impact since you use a payroll service which makes all the required remittances
- You should ask that Bank what “such other financial and operating statements and reports as and when the Bank may reasonably require” might be
- The Bank should be satisfied with the monthly and annual statements and the budgets
- (I had this clause for years, but the bank has never asked for anything)



Other points

- The company must ensure that it has no environmental issues, because of the strong standard clauses the Bank agreement includes in this regards
- This may require specialized professional advice
- The pay date of the term loan might be more convenient for of accounting/cash planning purposes on the 1st or last day of the month
- The monthly reports could be put in a spreadsheet, to facilitate the preparation thereof
- Perhaps the Bank has such a spreadsheet available
- It should be noted that some people find that wire transfers sent by Schedule B banks, are not as reliable as Schedule A banks



Other points

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Keep in mind

- I can't guarantee which/if any negotiating points your bank will accept, but it is good to be equipped with a lot of them...

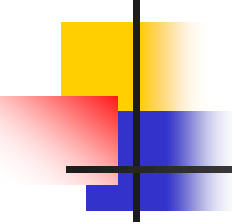
I was a 30 plus year Corporate/Commercial Banker and was impressed by the practicality of the section regarding dealing with a financial institution. There were numerous suggestions throughout the presentation that would aid in getting a more beneficial arrangement with your Bank

A recent attendee wrote: "we just had our yearly review with our bank and I applied several of the items from your course with great success. I was able to negotiate out of some personal guarantees and insurance requirements"



Closing

- A person in one seminar said he should read his own banking agreement, he never had!



Email me if you can think of
some other points...



You just heard quite a few negotiation tips

- There are many more in my half day seminar:
- **Practical Financial Negotiation Tips**
- Financial negotiation tips in many different areas, presented in a compelling way, with lots of examples
- Not a tactical negotiating seminar
- Showing financial and business creativity in negotiating
- **Includes negotiating your own salary!**



Don't fall asleep....or I will





Exercise time

- Those watching should do a few headstands

Exercise time

- Those watching should do a few headstands





We must make a phone call





Enron Corporation

- Possibly the greatest accounting scandal of all time...
- Who was hurt?
 - Enron shareholders
 - Innocent Enron employees
 - Innocent Arthur Anderson employees

...fering blackouts and paying sky-high electricity bills.

The utility wants an administrative-law judge to order Enron to surrender as much as \$2 billion in ill-gotten gains. California politicians want Enron to reimburse customers there at least \$8.9 billion.

The latest documents show Enron manipulated the market on 473 of 537 days from January, 2000, to June, 2001, the utility said.

The documents also show Enron maintained five separate sets of accounting records.

Enron, which filed for bankruptcy protection in 2001 amid a giant accounting scandal, refused to comment on the records except to say it is co-operating with all investigations.

Federal Energy Regulatory Commission spokesperson Bryan Lee said the agency would review the documents to see what new information they contained.

\$4.8 billion bid now

15-month option

LAS VEGAS—pushing ahead to create the company, being reimbursed its bid creator Mar after interstions.

MGM M the two significant material \$4.8 billion worth bid (dian), no would p their bid Mar entered



Ethics intro

- An important, difficult area
- I used to sit on the CMA Ontario Ad Hoc Ethics Advisory Committee
- Deadly serious, but I can't resist a few jokes!



One day

- The ethics advisor for a CMA legacy asked me if I knew any good ethics courses
- She said a member was sentenced to take one as part of the discipline for being found guilty of professional misconduct
- She said she found in the philosophy department of Athabasca University



Result

- I told her to send them to this course....
- If they ever attended, they didn't tell the class and I why they were there...



Ethics - intro

- Ethics in society – a comment
- In the news more than ever
- Our perception in society has been damaged by others' conduct
- Do people trust accountants in society?
- Who was the greatest Canadian business/accounting crook of all time?



Ethics - intro

**WARNING – DO NOT
CLICK THIS BUTTON!**

- Ethics in society – a comment
- In the news more than ever
- Our perception in society has been damaged by others' conduct
- Do people trust accountants in society?
- Who was the greatest Canadian business/accounting crook of all time?

Nortel executives shifted accounting funds to achieve results: Crown



Former Nortel CEO Frank Dunn leaves the Toronto court house where he and two other former executives are on trial for fraud, Jan. 12, 2012.

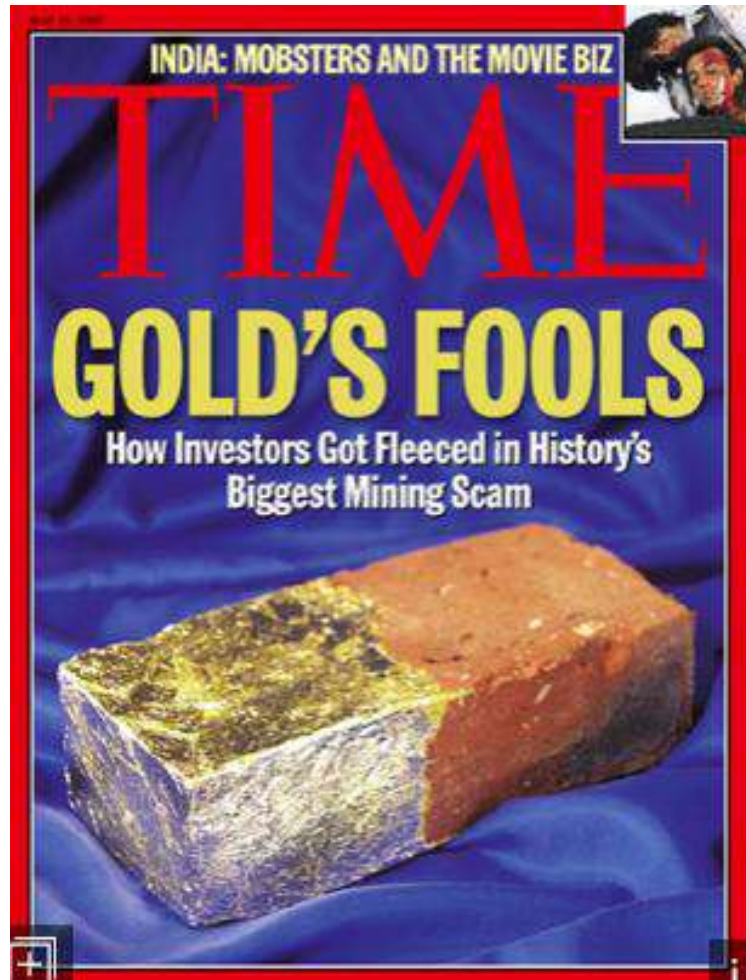
TRENDING

- 1 What we'll see at the L.A. auto show
- 2 From skeptics of Frank Lloyd Wright to believers
- 3 Honeymoon in Ireland: Making my new love fall for my first love
- 4 Price cut and relisting moves Leaside house during summer lull
- 5 Hudway Cast helps keep your eyes on

Nortel executives found not guilty on all counts of fraud

Three former top executives of fallen Canadian technology giant Nortel Networks Corp. were absolved of all counts of fraud on Monday

Bre-X?





Livent auditor Deloitte ordered to pay \$84.8-million for failing detect fraud



DREW HASSELBACK | April 6, 2014 4:21 PM ET

[More from Drew Hasselback](#)



Republish
Reprint





Conrad Black sentenced to 78 months in jail



Must report to begin sentence on March 3

CBC News - Posted: Dec 10, 2007 12:12 PM ET | Last Updated: December 10, 2007

Canadian-born Conrad Black was sentenced Monday in Chicago to 6½ years in prison for his role in the misappropriation of millions of dollars from the newspaper empire he once headed.

Settlements approved for Castor Holdings in two-decade legal battle



Financial documents belonging to Castor Holdings Ltd. are seen in a file photo.

SHAUN BEST/REUTERS

JANET MCFARLAND > REAL ESTATE REPORTER
PUBLISHED JULY 22, 2015
UNPUBLISHED JULY 15, 2015

Investors win more than \$1-billion in Castor Holdings case

A Quebec judge has ruled in favour of investors seeking more than \$1-billion in damages in the infamous Castor Holdings Ltd. fraud case, writes Kathryn Leger on the Moves, Deals and Takes blog for the Montreal Gazette.

TRENDING

1 The berry with more antioxidants than blueberries was no second for Indigenous people

2 OPINION
We need to come clean with millennials on big-city home ownership dreams

ROB CARRICK

3 OPINION
Off-court defiance rather than court skill defines Eugenie Boreaux

ried on:
the have t



BUSINESS DAY

Ebbers Sentenced to 25 Years in Prison for \$11 Billion Fraud

By JENNIFER BAYOT JULY 13, 2005

Bernard J. Ebbers, the founder and former chief executive of [WorldCom](#), was sentenced to 25 years in prison today for his role in the record \$11 billion accounting fraud that brought down the telecommunications company in 2002.



DR Capital assets \$3.75B USD

CR Cash \$3.75B USD

SHOULD HAVE BEEN DEBIT EXPENSES, BUT ARTHUR ANDERSON MISSED THIS!



A recent nomination from
someone in the class

A recent nomination from someone in the class





Someone else said....



In scathing pre-election report, Ontario auditor general says deficit is \$11.7B, not \$6.7B

The accounting disagreement stems from a longstanding dispute over whether around \$11 billion in the OPSEU and the Ontario Teachers' pension plans can be counted toward the bottom line.





My nomination

- My career paralleled this guy's
- We both were planning to become CAs
- He was at PWC, I was at KPMG in Ontario
- I passed
- He failed
- He now lives near Kingston, Ontario
- Here is his home:

My nomination

- Here is his home:



My nomination

- Here is his home





Paul Bernardo

Serial Killer

Paul Kenneth Bernardo, also known as Paul Jason Teale, is a Canadian serial killer and rapist, known for the highly publicized sexual assaults and murders he committed with his wife Karla Homolka and ... [Wikipedia](#)

Born: August 27, 1964 (age 51), Scarborough, Toronto, Canada

Nationality: Canadian

Spouse: Karla Homolka (m. 1991–1994)

Parents: Kenneth Bernardo, Marilyn Bernardo

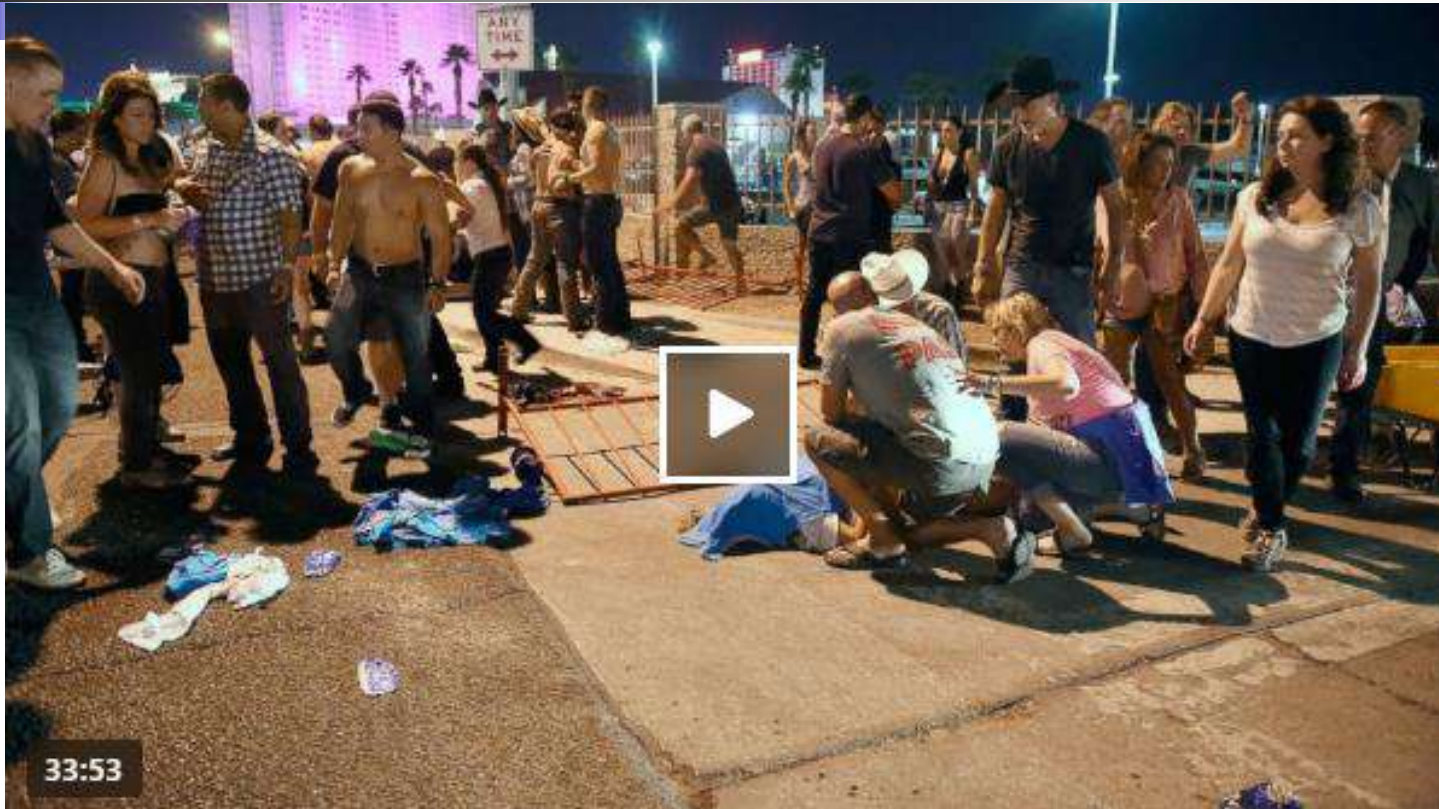
Convictions: Murder, Sexual assault

Education: University of Toronto Scarborough, University of Toronto, Sir Wilfrid Laurier Collegiate Institute



Another crooked accountant/auditor

Another crooked accountant/auditor



Sadly, the Vegas shooter...

A crooked accountant in Bermuda



Hiscox accuses former executive of \$1.8m fraud

Jonathan Kent, Business Editor

Published Jun 15, 2018 at 8:00 am (Updated Jun 15, 2018 at 3:07 pm)

57
Shares

f Share

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✉️ Email



First Prev **1** Next Last



Hiscox action: the Bermudian insurer has sued former executive Yuval Abraham

SCEPTRE 50" LED HD TV

SCEPTRE 50" LED HD TV

BIG WHEEL RIDE ON

16" CLASSIC, PINK, OR BLUE

BOY DEAL 389.00

BOY DEAL 50.00

Hiscox has accused Yuval Abraham, a former executive who was based in Bermuda, of misappropriating more than \$1.8 million.

The Bermuda Supreme Court ordered a worldwide freezing of Mr Abraham's assets on April 25 this year, on the same day that three Hiscox entities — Hiscox Services Ltd, Hiscox Agency Ltd and Hiscox Insurance Company (Bermuda) Ltd — had sued him.

A spokesperson for Hiscox, the Bermudian-based

Hiscox accuses former executive of \$1.8m fraud

Jonathan Kent, Business Editor

Published Jun 15, 2018 at 8:00 am (Updated Jun 15, 2018 at 3:07 pm)

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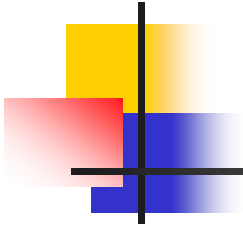


First Prev 1 Next Last



In its application, Hiscox states: "In 2017 and 2018, Mr Abraham falsified invoices and used his position to cause Hiscox to pay over a million dollars to Montres Journe New York in exchange for luxury watches.





Bermuda CFO arrested in Greece

Paul Johnston

Published Sep 27, 2019 at 8:00 am (Updated Sep 27, 2019 at 8:14 am)

3 Comments

12
Shares



Share



Tweet



Print



Email



First Prev 1 Next Last



Yuval Abraham



A former chief financial officer of a Bermudian-based reinsurance firm accused in a \$1.8 million fraud scheme has been apprehended overseas, police announced yesterday.



Ethics - more

- Were you taught ethics at university/college?
- Can you lose your university degree/college diploma for being unethical? – _____
- “Many accountants are careful in public practice but do anything in industry” ethics advisor quote
- We will discuss some principles
- Then we will go through some mini cases



Question

- Do you ever read the disciplinary notices on CPAs for:
- Education
- To see if former colleagues got in trouble
- Entertainment?

Decisions, Orders and Reasons in Cases involving Disciplinary Proceedings

Index Of Disciplinary Proceedings By Name

A	Rule(s)	
A MEMBER	201.1	Get File
ABRAHAM, D.M.	201.1	Get File
ADAIR, J.A.	201.1, 205	Get File
ADAIR, L.E.	201	Get File
ADAMS, L.	104	Get File
ADAMS, L.	203.2	Get File
ADAMS, S.Z.	201.1	Get File
AGULNIK, M.B.(SETTLEMENT)		Get File
AITKEN, J.D.(SETTLEMENT)		Get File



Question

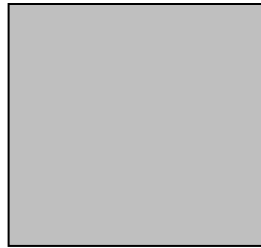
- Do you ever read the disciplinary notices on CPAs for:
- Education
- To see if former colleagues got in trouble
- Entertainment?



Ethics - more

- Were you taught ethics at university/college?
- Can you lose your university degree/college diploma for being unethical? – normally no
- “Many accountants are careful in public practice but do anything in industry” ethics advisor quote
- We will discuss some principles
- Then we will go through some mini cases

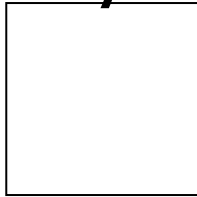
Some might say, "it's just a gray area..."





“It’s just a gray area...”

- No, ultimately, if it looks gray, it needs to be pushed into one of these boxes for you:





It's just a gray area

- Name of a seminar by a CFO who got out of jail: *The gradual slippage from "it's just a gray area to what were we thinking?"*
- Little matters become big matters, little compromises become big compromises





BAU 2: Example 5: Richard Scrushy



- **Jail:** U.S. Penitentiary in Beaumont, Texas
- **Release Date:** June 8, 2013
- **Crime:** Former HealthSouth Chairman and Chief Executive Richard Scrushy, 56, was found guilty of bribery and mail fraud for his participation in a scheme to pay \$500,000 bribes in return for a spot on a state regulatory panel.
- **Prisoner Number:** 24463-001

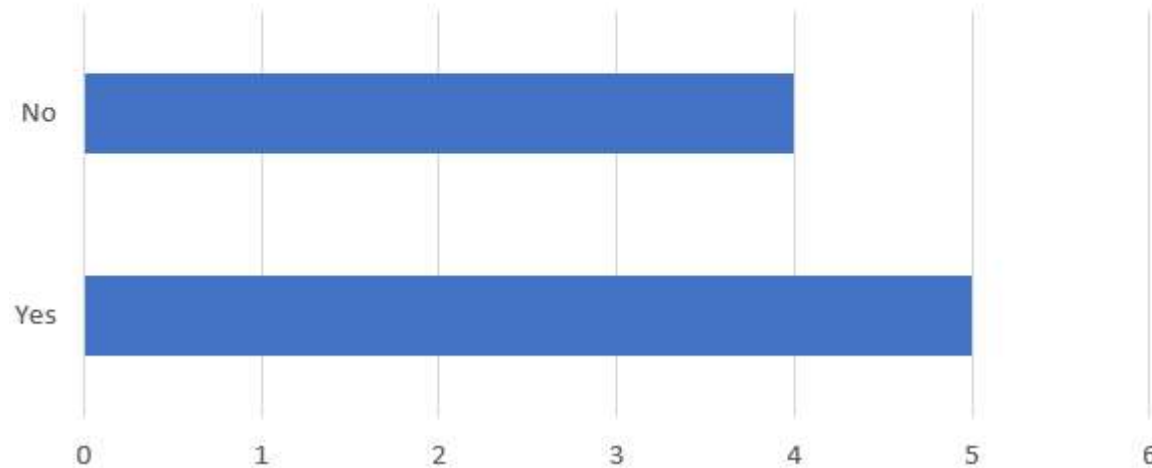


Note

- A lot of unethical behaviour seems to come from the over-bearing, no one dares to question, founding CEOs
- I have run into this myself...

Polling question

"Have you ever worked for a difficult over-bearing, no one dares to question owner or CEO?"



Have you ever had a

- Bungee CEO....? hired, fired, then hired, fired...



I have had two!



Ethics - advisors

- I obtained input from an ethics advisors some of the scenarios (two former advisors have taken this course with me)
- CPA ethics advisor can be consulted in confidence
- Will not/cannot give you absolutely conclusive answers and usually nothing in writing



Rules of Professional Conduct

Chartered Professional Accountants of Ontario

CPA Code of Professional Conduct

205 False or misleading documents and oral representations

RULE:

A member or firm shall not

- (a) *sign or associate with any letter, report, statement, representation or financial statement which the member or firm knows, or should know, is false or misleading, whether or not the signing or association is subject to a disclaimer of responsibility, nor*
- (b) *make or associate with any oral report, statement or representation which the member or firm knows, or should know, is false or misleading.*

Quebec

- *34. A member shall not sign, prepare, produce or even associate his name with any letter, attestation, opinion, report, statement, representation, financial statement or other document, which he knows, or should know, contains false or misleading information, out of complacency or without ensuring that such documents are in compliance with good practices or current scientific knowledge.*



Question

- Since oral is not mentioned in the Quebec 34, does that mean a Quebec CPA can say whatever they want?



I asked CPA Quebec

- «To answer to your question, Quebec CPAs have to be careful to what they say. In addition to rule 34, rule 5 asks to our members to act with dignity and avoid any method or attitude that is likely to damage the profession's good reputation. In rule 34, even if the word « oral » is not written in our Code of ethics, this is implicit »



Example

- You give a false or mis-leading budget number out internally at work, this almost certainly doesn't violate any law, but it does violate CPA 205 (34 Quebec)



Rules of Professional Conduct

- Notes: something can violate 205/34, but not break any law...
- Ultimately they are about lying
- We can all be tempted to lie, but no one likes being lied to!



Question

- Does saying, “I was just following my boss’ orders”, avoid ethical problems?
- Answer: no!
- Not in the world of war crimes

Nuremberg trials 1945-46 of Nazi leaders for war crimes



I was just following Hitler's orders,
I am not responsible





Conclusion at Nuremburg

- “Superior orders, even to a soldier, cannot be considered in mitigation where crimes as shocking and extensive have been committed consciously, ruthlessly and without military excuse or justification”

The answer





Or the CPA world

- You are responsible for your conduct...



A crooked bank

- I used to bank with them
- They seemed to follow AML (Anti Money Laundering) rules in the UK, then....

A crooked bank

Danske Bank money laundering scandal



The Danske Bank money laundering scandal arose in 2017-2018 around €200 billion of suspicious transactions that flowed from Estonian, Russian, Latvian and other sources through the Estonia-based bank branch of Denmark-based Danske Bank from 2007 to 2015. It has been described as possibly the largest money laundering scandal ever in Europe, and as possibly the largest in world history.



Ethics – difficult situations

- Public companies
- Management incentives
- Imminent takeover
- Survival of organization/raising financing
- Incomplete information and ____ pressure
- Does being a contractor, not an employee change anything?
- What about working outside Canada?



Insider trading

- I was once an “insider” executive of a public company, with disclosure of trades required and there were blackout periods we couldn't buy or sell shares
- I actually never traded any stock, I always felt I knew more than outsiders
- Plus the stock was going down most of the time!





Bribe request I heard about recently (seminar attendee)

- *"It will take several months for your company to get government approval, by the way I would like my son to study at university in Canada, this is what the tuition fees cost"*
- Response from Canadian company: "we can wait"



Ethics – some advice

- What is the intent? (can it be achieved ethically?)
- Is it illegal? (Consult a lawyer)
- Is it fair?
- What would people think?
- Does anyone get hurt?
- What is the impact on the various stakeholders?

Ethics - some questions

- Consider your reputation/reputation of your profession
- Would you be proud of your actions?
- Think about your whole career, not just the moment
- Would you tell your son/daughter?



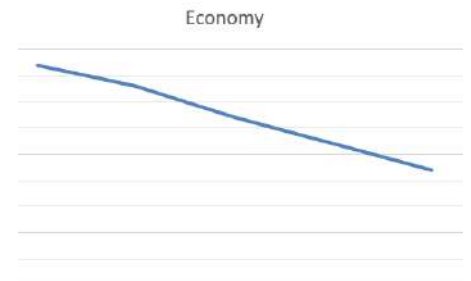
Ethics – some questions

- Consider your reputation/reputation of profession
- Would you be proud of your actions?
- Think about your whole career, not just the moment
- Would you tell your son/daughter to do it?



Ethics – other considerations

- Are you telling the truth?
- Does materiality matter?
- Would you rather be an ethics hero, than a villain?
- Who were the Enron heroes? Watkins and Bass
- The economy and ethics





Ethics - pragmatically

- Make your ethical standards clear to all
- Then they will respect you
- Should you have final say on the numbers if you are the CFO?
- Could you reference the CPA code of conduct in your employment contract?



Chambre de Commerce et d'Industrie de la Région de Bruxelles-Capitale
2015 - [Table de Travail et Bureau avec Armoire de rangement](#)
www.cci.brussels





Excerpt from my current employment contract

Code of Ethics:

The Company understands that the Employee is bound to follow the Code of Ethics and Professional Conduct for Ontario Chartered Accountants, as amended from time to time.

<http://www.icao.on.ca/resources/membershandbook/1011page2635.pdf>



What to do under pressure

- Play dumb (may help you get around a problem - won't help in court/disciplinary proceedings)
- Tell them to put it in writing
- Suppose they refuse? Send them an email to confirm the instructions
- Explain the situation in another way



From: Stephen Priddle [<mailto:spriddle@company.com>]

Sent: November-08-19 4:27 PM

To: David Fraud <CEO@company.com>

Subject: Your request

David,

This is to confirm that at 10 AM in the large headquarters meeting room, you requested me to falsify the November 502 report to the stock exchange, so they won't know that the company_____

Stephen Priddle



The correct invoice

INVOICE

Harkom Corporation

1 Hamilton Drive

Canada

BILL TO

Asia Imports Limited

INVOICE #

101112

INVOICE DATE

30/11/2018

DESCRIPTION	AMOUNT
One Fiber Optic Multiplier XG442 Unit	100,000.00
TOTAL	\$ 100,000.00



They want this

INVOICE

Harkom Corporation

1 Hamilton Drive
Canada

BILL TO

Asia Imports Limited

INVOICE #

101112

INVOICE DATE

30/11/2018

DESCRIPTION	AMOUNT
One Fiber Optic Multiplier XG442 Unit	10,000.00
TOTAL	\$ 10,000.00



Note

- You could face the value for customs issue while doing on-line shopping...



Note

- I would address the issue of what documents/e-mails you can keep with a lawyer and an ethics advisor, because of confidentiality and ownership issues

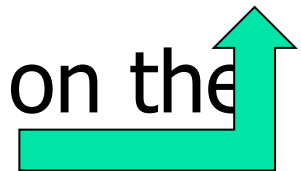
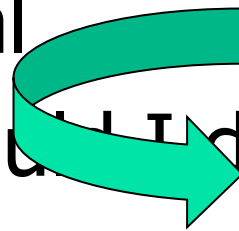


Ethics - pragmatically

- Keep a chronology of all events
- The importance of good documentation
- Get someone else involved
- Be very careful before going above your boss
- Huge personal and career implications of taking a stand
- You may have to resign

Real life mini case

- The CFO and I (the controller) are in a dispute over revenue recognition on a deal that is coming in. The CFO wants to recognize revenue three times on the same deal.
- What should I do?
- Solution: _____
- Lesson: _____





Real life mini case

- The CFO and I (the controller) disagree on revenue recognition on a contract that is coming up, he wants to recognize revenue three times on the same deal
- What should I do?
- Solution: Can't, S. 3400 of Handbook, Got CEO involved to help. Agreed to let auditors settle the argument.
- Lesson: Get someone else involved. Third parties like auditors may help to settle ethical dispute.



Dealing with pressure

- A parenting tip, that may help you with ethics
- We taught our kids the respectful appeal rule
- If you feel there is confusion about an order, or your parents are being unfair
- Respectfully say to us, “Mum or Dad, I would like to appeal _____”



Dealing with pressure

- Don't over-use it and make sure the appeal is well-grounded
- Do the same with the person who is trying to get you to be unethical
- "I would like appeal this request you have made of me, for the following reasons"
- Make sure some reasons have self-interest for them



Note

- Don't sign anything if you are not comfortable with it
- CPA signing something brings a lot of credibility, but it must follow relevant professional standards and ethics



One day

- I have been with a company for 6 weeks
- An important board member orders me to sign (for self-directed RRSP purposes) that the company's share are worth \$2/share
- He almost has a melt down, when I say I can't just sign that, because I saw no support for the amount



One day

- We were able to resolve this issue by me writing a note
- “Independent investors have bought common shares of the company 8 weeks ago for \$2/share, suggesting a market value at that time”
- Factual, supported, resolved the problem



A KPMG ethics situation

- I am doing a Review Engagement Report file for a small retail client in my first year
- I must determine the “plausibility” of this year’s gross profit %
- Notes in the file say the target gross profit is 43%, although last year’s looks like about 30%
- This year’s gross profit is about 30%
- I can’t sign off that gross profit is plausible, based on the information I have



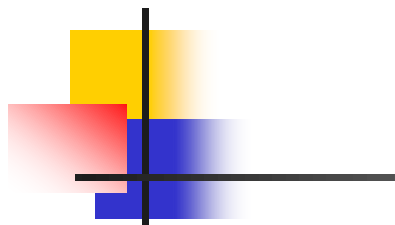
A KPMG ethics situation

- This caused quite a controversy until someone found that the target mark-up not gross profit, for items sold was 43%, this was not the target gross profit, so the issue was resolved
- \$70 item, marked up 43%, times 1.43 = \$100
- Gross profit $\$100 - \$70 = \$30 \rightarrow 30\%$

Ethics – your organization

- Is violating company policy unethical?
- Is an ethical approach projected from the top down?
- Does company have a written code of ethics?
- Do you have a whistleblower line?





|Code|of Ethics

July, 2000



Sample code of ethics

- We are dedicated to conducting business according to all applicable local and international laws and regulations, including, but not limited to, the U.S. Foreign Corrupt Practices Act, and with the highest professional and ethical standards.
- At Enron, we treat others as we expect to be treated ourselves. We believe in respect for the rights of all individuals and are committed to promoting an environment characterized by dignity and mutual respect for employees, customers, contractors, suppliers, partners, community members and representatives of all levels of Government.



Question

- (to the only Canadian who went to jail for the Enron scandal – not for the accounting side)
- How could you have gone ahead with it?
- Everybody had nice suits and ties and this made it sound legit' and I didn't want to stand up and say, we should not do this..."



The only Canadian who went to jail for Enron crimes – from the public record

In a letter to a U.S. probation officer, a copy of which was filed in court, Mr. Delainey acknowledged that his rapid rise through the Enron ranks had become "intoxicating," and that by 2001 he participated in financial manipulations that he knew were wrong.

"At the end of the day, I lacked the courage to stand up and do the right thing," he wrote.



Peer pressure

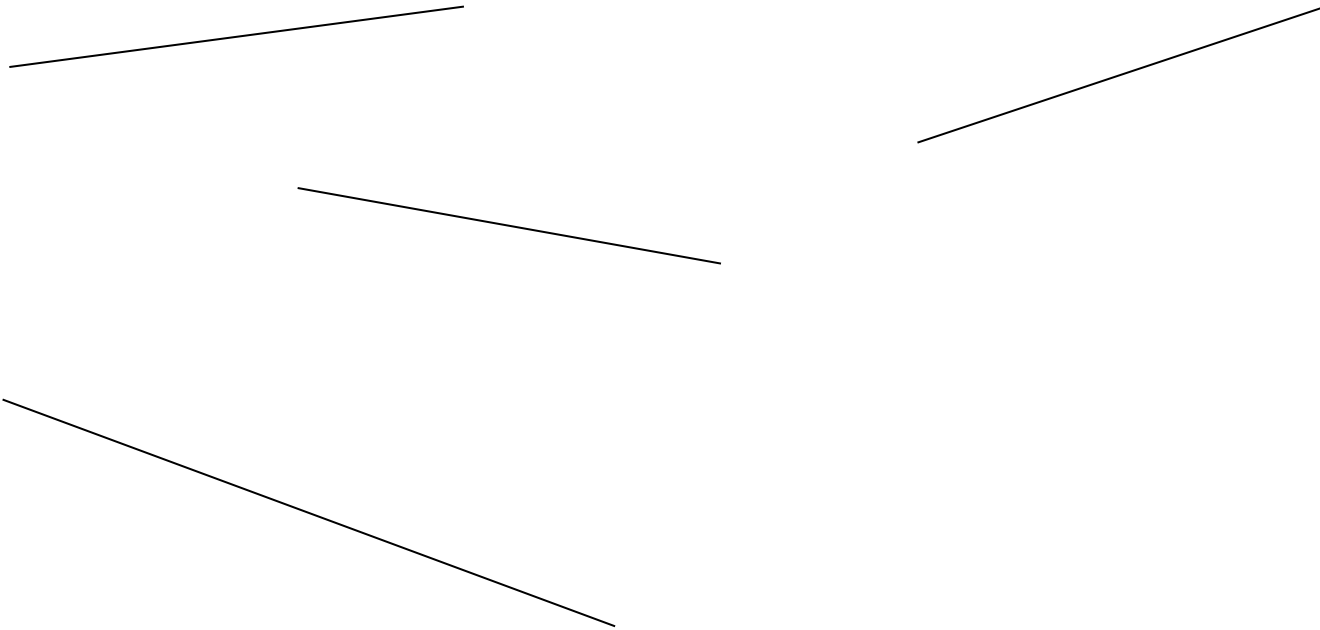
- Exists in businesses, not just for teenagers
- If the peer pressure is to be unethical, don't follow it!
- I like to do the "peer pressure" test on people, particularly teens...



The peer pressure test

- You need 5 people
- The first 4 are in on the test
- In sequence, they are each asked a question in front of the others, which they deliberately get wrong
- You then find out if they “follow the crowd” the peer pressure and give the wrong answer, or they stand up independently and give the right answer

For example, which line is longest?





Code of ethics reinforcement

- At IBM – my friend said he had to re-sign it once a year (in Sales)
- One guy said he had see it every time he logged into his computer!



Whistleblower line

- Who has one?
- Let me call it right now, we could test it with fictitious fraud story...
- One past attendee said he called it once as part of an internal course on ethics!



From: Stephen Priddle [<mailto:spriddle@company.com>]
Sent: November-08-19 4:27 PM
To: David Fraud <CEO@company.com>
Cc: Whistleblowerline <whistleblowerline@company.com>
Subject: Your request

David,

This is to confirm that at 10 AM in the large headquarters meeting room, you requested me to falsify the November 502 report to the stock exchange, so they won't know that the company_____

Stephen Priddle



Put the whistleblower number
on the wall of your office?

1-800-WHISTLE



Customer Service is available 24/7. 1-800-WHISTLE (947-4788) is available 24/7. **25. Take a Whistle Break with a Local Representative.** **26.** **27.** **28.** **29.** **30.**





Audit Committee

- If you have one, hopefully fully independent and can help you
- But this is not guaranteed
- A story:
- Internal auditor auditing suspicious medical funding project, hospital, they won't answer certain questions
- Tells Audit Committee chair who says "don't ask those questions"
- CPA reports scope limitation, resigns in disgust



The audit representation letter

- I am working for a high profile company
- The rep letter is normally signed by the CEO & CFO
- Auditors didn't particularly trust the CFO, and really trusted me
- They asked that I sign it as well
- The CFO was upset, asks me why?
- I played dumb..



The audit representation letter

- When audit was almost over, I got new info on an inventory valuation issue
- Meant I could not honestly sign the rep' letter, so I refused until the issue was dealt with
- I just told the auditors I am not signing, but not why



Ethics overall

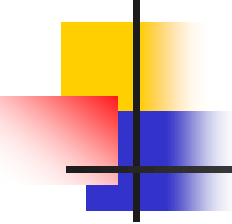
- Work ethics are a subset of ethics in life
- Is the solution regulation, or inner character
- Biggest influencer on you may be your _____
- The bigger question...
- Integrity and success go together, in the long run...



New Professional Conduct Rule 269.1

- *Each member must report all highway traffic offences to the Professional Conduct Committee which will consider disciplinary procedures with due consideration to the damage to the reputation of the profession.*

JOKE!!!

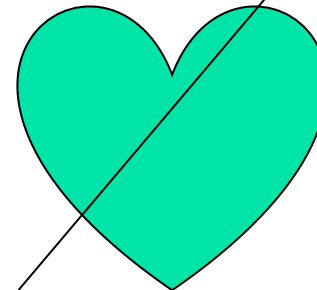


Are there good accountants and unethical accountants out there?

- “If only there were evil people somewhere insidiously committing evil deeds, and it were necessary only to separate them from the rest of us

Are there good accountants and unethical accountants out there?

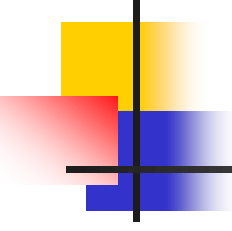
- “If only there were evil people somewhere insidiously committing evil deeds, and it were necessary only to separate them from the rest of us **But the line dividing good and evil cuts through the heart of every human being**”
(Solzhenitsyn)





Suggestion

- Let's all evaluate our own hearts...



A course teaches the following are needed for fraud to take place

- Opportunity
- Incentive
- Rationale
- (one might add: the idea that no one will ever find out about it)
- But I would say **if you have good character, it does not matter!**



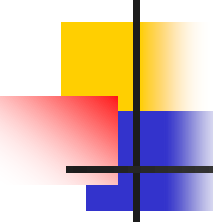
Ethics overall

- Work ethics are a subset of ethics in life
- Is the solution regulation, or inner character
- Biggest influencer on you may be your family upbringing
- The bigger question...



Ethics applied

- We will go through some cases covering a wide range of situations
- There are some bonus case with solutions to be provided later, which we won't here, you can look at them later



If there are strange things in
this course, they are designed
to keep you awake!



Case

You are the CFO of a company that has a bank operating credit facility with a major Canadian bank. The operating facility is based on 75% of Good Domestic Accounts Receivables with some other adjustments. The phrase Good Domestic Accounts Receivables is not defined in the Banking Agreement. Your company is having some financial difficulty and the CEO asks you to sign off the monthly banking report for May 31, including three receivables in the margin calculation, with a face value of \$156,344. You know that authorizations for goods to be returned by these customers of \$84,000 have been issued by Sales. About half of these were authorized before May 31 and half after May 31. You have recorded accounting provisions for the returns authorized before May 31



Case

- \$84K or receivables don't really exist for all intents & purposes, no customer will ever pay them, credit notes will be issued
- The time of authorization has no impact
- You clearly know this, thus accounting return provisions
- Mis-leading and false to the bank
- Bank would not be able to realize on them as collateral
- Therefore cannot sign
- However, if the CEO allows me to **disclose** this situation in a note, not a problem at all
- Lesson: Full disclosure sometimes takes away the ethical dilemma, the communication is no longer misleading



A recent personal ethical issue

- I am in a store and I accidentally break some merchandise!

A recent personal ethical issue

- I am in a s
merchandise

some



- I did full disclosure to take away the ethical issue...They said "don't worry sir"



Forecasting

- Two things we can forecast for sure
- Death and taxes....
- Benjamin Franklin)



Case

- You are the Controller of a company and the senior finance person, reporting to the President. For years the company has been able to earn a gross profit of 45-47% on its product sales. In some future-oriented financial information you are preparing for potential new investors in the company, the President instructs you to show a gross profit of 54% explaining that it is imperative that the company gets this new investment. You need to e-mail the forecast to the investors later this afternoon.



Analysis

- Let's give the benefit of the doubt, to the President
- Play dumb, ask how is this justified, given the historic gross profit
- Perhaps the new investment will justify the cost reduction because it finances better production equipment
- Disclosure of past margins would certainly tell users that these future results are unlikely
- But if there is no justification, there may be a problem



More analysis

- (The information can't be false, because there is not truth, it is the future, we don't know for sure what will happen)
- If not justified, this forecast may be misleading and could get you in trouble under rule 205/34 Quebec
- Noting that it is the President's forecast, not yours, doesn't help
- You are associated with information and ought to know
- A disclaimer if you email it doesn't help (CPAs outside Quebec)



Case # 2

- Consider FOFI rules principles
- The Handbook says in 4250
- **A forecast** (plan and probable economic conditions) versus
- **A projection** (plan plus hypotheses, not necessary most probable)
- Therefore, if called a **projection**, you are probably OK



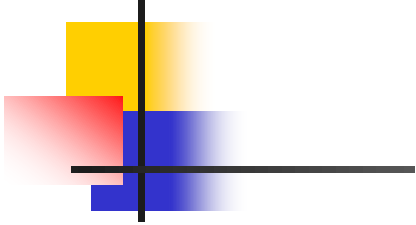
Forecast versus Projection

FIVE YEAR GC FORECAST/PROJECTION								
Historic	Year	2020	2021	2022	2023	2024	Total	
2014-2019								
5	Forecast	1		1		1	8	
5	Projection	2		3		3	13	



Case # 2

- Many CPAs object: users won't know technical difference between a forecast/projection per the Handbook
- I tend to agree, but this is what the rules say
- Some say that in the start up fund-raising world, investors know any forecast is a hope, rather than a prediction, after all the product is not even complete...so it doesn't matter
- I always call forward looking numbers **projections** to be safer, but also want them to be reasonably justifiable
-



▼ Zoom Group Chat

From Anonymous to **Everyone**:

Is it break time?





Case

- You are the new CFO of a private company. You have just become aware that sales has been rigging bids on government contracts. You have seen a recent newspaper article, where a company engaging in a similar rigging operation was fined \$1.2M
- What would you do?

A decorative graphic consisting of overlapping yellow, red, and blue squares with a black crosshair.

Joke

- In one seminar, a guy said call “Robert Half”
- Then a Robert Half CPA in the seminar starting handing out his business cards...

Robert Half recruitment agency in Canada provides professional recruitment and employment services. Call now and find the staff your business needs.



Bid rigging explained

- Several bidders work together to rig the bids on contracts
- Only bidder 1 and bidder 2 bid on this government contract, one bid very high, and the other bid just a little lower
- Next government contract, bidder 1, 2 and 3 will all keep their bids high, etc
- My brother was on the jury for bid rigging murder trial!



A bidder stepped out of line, and the other paid someone something like \$10,000 to kill him, the trial was of the contract killer...



Analysis

- Don't worry, it has nothing to do with you? You are not involved or associated, you are minding your own business in the finance dept
- No, there are at least financial reporting implications of this if it is material
- But what is the **big** question?
- If the CEO/Board know about and support the bid rigging, a big problem
- If they don't, this is one or two rogue employees, when reported internally they will be fired and the matter cleaned up, then everything will be fine



More

- A contingent liability note will be needed at a minimum if you stay there
- The CEO would not like the matter explained in a note, so the note may have to be like this!

Note 9 Contingent Liability

The company may be required to pay a material amount to a certain government body. The amount and the outcome are not reasonably determinable at this time and no amount has been recorded in the financial statements.



Assuming a deliberate management plan

- The CEO and others will not want this to be revealed
- Call 911 or the Competition Bureau, this act might be criminal?
- No, you probably can't due to CPA/Corporate confidentiality
- Rule 48 Quebec, Rule 208.1 outside Quebec
- What an ethics advisor said – Ontario
- Other designations on confidentiality and reporting...
- Is there a whistleblower line or an Audit Committee, then confidentiality would not be a problem



Question

From: Stephen Priddle [<mailto:spriddle@bell.net>]

Sent: Friday, December 07, 2018 3:41 PM

To: Ethics Advisor

Subject: RE: Question

Ethics advisor,

Are there any conditions that a CPA can violate CPA confidentiality and reports something criminal to the police? Or does confidentiality, 100% always over-ride?

Stephen Priddle



Response

Stephen

...a member must follow Rule 208.1, *Confidentiality*. If a member is thinking of deviating from Rule 208.1 for any reason it is advisable that the member first seek legal advice and obtain a legal opinion.

Kind regards,

_____ CPA, CA, CBV
Regulatory & Standards, Advisory Services
_____@cpaontario.ca



The disclaimer attached

- *The Member Advisory and Practice Advisory service of the Chartered Professional Accountants of Ontario is a confidential service that is intended to provide informal feedback on accounting and assurance issues as well as interpretations of the Rules of Professional Conduct. Feedback is general in nature as the advisor may not have all the necessary information. The assistance provided is not an opinion and is not binding on CPA Ontario. By accessing this service, you accept responsibility for conducting your own due diligence and using your professional judgment, and you agree to release and indemnify CPA Ontario and the Member or Practice Advisor for any claim to damages that could result based on your discussion. We attempt to respond to all queries within 24 hours. Emails will likely be responded to by telephone.*



More

- You don't want to be employed with a company that has such practices. You don't want to be known in your career to be working for an unethical company
- Consider resigning
- A lady who took this course said she has only two companies on her resume – both famous & crooked!
- I once had a public company audit client accused by the government of bid rigging
- They maintained their innocence, but reported a contingent liability note in the financials for years
- Then they were found guilty and paid a large fine



Two employers

- Enron (Canada)
- And Philip Services



Former Philip Services exec charged in \$28M fraud



CBC News - Posted: Dec 20, 2004 11:09 AM ET | Last Updated: December 21, 2004

A former executive at Philip Services Corp. was charged Monday by the RCMP with defrauding the company of roughly \$28 million.

Robert Waxman, 49, of Ancaster, Ont., faces 12 counts of fraud over \$5,000.

Waxman was president of the company's metals group from February 1996 until September 1997, when he was relieved of all his duties.

Police allege Waxman committed a series of complex fraudulent transactions, leading to profits being siphoned off into "shell companies" in which police say he was a "beneficial owner."



More

- You don't want to be employed with a company that has such practices. You don't want to be known in your career to be working for an unethical company
- Consider resigning
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- Then they were found guilty and paid a large fine



A really crooked company story

- There is a huge Canadian public company accused probably of being more crooked than any Canadian company in history!



The accusation

- The company is accused of helping the Sudanese government kill large numbers of people in the south of the country
- Many called for divestment of company shares and pushed the Canadian government to penalize the company



Situation

- My father writes letters to the government of Canada and to the company expressing concerns
- (He is a heavy weight in the industry the company is in)
- The public company surprises him by asking him to join the Board
- What should he do?



Result

- He decides to join the board, and makes a personal pledge to help this in Sudan from this position and give every \$ he makes to help those impacted in Sudan
- Goes to Sudan, speaks up for the those there, finds the oil company is very ethical (other oil companies there weren't)



The company

- **Talisman Energy Inc.** was one of Canada's largest oil companies, with a major investment in Sudan



Company Name TALISMAN ENERGY INC.SOCIETE DENERGIE TALISMAN INC.

Company No 3671119

Business Type Distributing corporation

Status Inactive Amalgamated

Governing Legislation Canada Business Corporations Act - 1999-10-15

Officers/Directors LAWRENCE G. TAPP
ROLAND PRIDDLE
DAVID E. POWELL
JAMES W. BUCKEE
DALE G. PARKER
AL L. FLOOD
DOUGLAS D. BALDWIN
PAUL J. HOENMANS
STELLA M. THOMPSON



Case

The President and founder of the company, for which you are the Controller, asks you to book the following material journal entry, when the CFO is away:

DR	Accounts payable	\$3.24M	
	CR	Revenue	\$3.24M

She refuses to give you any explanation or supporting documentation for it and asks you to resign your position if you don't want to book it. The company is listed on TSX Venture Exchange and the year end audit starts in 5 weeks.



Discussion

- This is from the Enron school of accounting!
- Someone said, what would that funny Newfoundland guy do?
- Just book and reverse it!
- The big issue
- The A/P subledger won't balance!



More seriously

- This is called “management over-ride”
- Greater exposure and risk since public but same fundamental issue with any organization
- Obviously the entry is false and misleading if not supported
- Asking the President to put the request in writing may remove the issue
- Consider whistle blower line and Audit Committee
- Remember the CFO is above you, and hopefully you will take the same position on this issue
- CC the CFO on correspondence
- Call the CFO even though they are away and check on journal entry approval rules



What do you do?

- One attendee once suggested that if there are ethical difficulties, just drop an anonymous note to the auditors
- In my mind you can tell the auditor anything, especially if you are signing the management representation letter, essentially disclosing you have disclosed everything
- But one CPA ethics advisor wrote me:



The ethics advisor

"Hello Stephen,

Industry CAs' relationship with their company's auditors is a tricky one. Whether they can discuss the company's problems with the auditor is a grey area. I often suggest the CAs discuss their concerns with the audit committee and if they feel they should talk to the auditors, I recommend they first seek legal advice from a lawyer familiar with our rules of professional conduct."

Another angle



- An auditor was alone with a clerk
- The clerk said: “just look in this drawer, I am leaving the room..”
- Obviously revealing some kind of important secret file to the auditors
- A clerk is not bound by CPA confidentiality and possibly not corporate (executive) confidentiality
- A clerk or other colleague may be able to report something you can't
- Get legal and ethics advisor advice....



Employment law

- Don't resign under pressure
- Consult an employment lawyer
- Tell them to give you a package if they want you out
- They may be afraid to terminate you, because of what could come out if you sue and there is a court case



And

- Do really want to work for this President?
- Therefore, get them fired is the best outcome!



Case

You are the Comptroller of a company that invoices its customers for parts and labour on certain contracts. Your company is in the middle of a project for a customer. The customer has issued a purchase order for \$60,000 of project labour based on 600 hours of labour at \$100 per hour and another purchase order for \$10,200 of project materials. The project labour invoiced to date has been \$52,314 and is expected to be to be less than \$55,000 in total, and project parts have been \$10,200. Your company finds that there are \$4,000 more parts to invoice. The customer's project manager said to speed up approvals, "just invoice the parts against the labour purchase order as 40 hours of labour". Your company's sales representative has agreed to this.



Notes

- Typical big company situation
- Take a short cut, because doing the correct paperwork is such a hassle
- Maybe the most controversial case in this course!
- Some would say both parties agree, there is no cash impact, it is fine
- They hotly defend this practice, perhaps because they do it



Analysis

- This is the invoice they are asking for
- Can you just say it is immaterial? No
- This does not comply with PO terms
- Only some parties agree, not all parties are aware
- A false and misleading invoice will be produced by your accounting system
- Accounts payable and approvers of bill at customer need to be able to trust the description on invoices
- You may be helping the customer's project manager deceive his/her superior
- What about the next time when they ask for a bigger false line on an invoice? \$70,000, \$700,000?

INVOICE



Blaney Corporation

1 Hamilton Drive
Canada

BILL TO

Ways Property Limited
41643 Wander Street
City, Canada

INVOICE #

101112

INVOICE DATE

29/11/2019

DESCRIPTION

AMOUNT

40 hours labour @ \$100.00 per hour(PO#53432)

\$4,000.00

Subtotal

\$4,000.00

HST 13.0%

\$520.00

TOTAL

\$4,520.00



Analysis

- Issue may be uncovered by a supplier audit – large companies have them
- There may be commodity tax issues if parts and labour are taxed differently
- This could result in problems for the company's inventory accounting, inventory won't be relieved without special intervention
- There may be revenue recognition impacts
- There could be bonus calculation implications on the supplier side
- There could be bonus calculation implications on our side
- **I would not allow this to be done!**



More

- A participant said, if a normal person read this in the Globe & Mail, what would they think – were you cheating?
- I think they would if they fully understood it
- I stamped this out in a company I worked for
- I scared one sales person considering this approach, by writing a fake article in the newsletter of our famous customer's internal newsletter;
- Headline: **Supplier audit uncovers irregularities with Company X, staff terminated**



Management issues

- Need better management of prediction of costs
- Need improved management of cost overruns as a business practice
- Need better communications with sales



Case

- You are the new Manager of Finance for an owner-managed company. Recently the bookkeeper told you that the owner said that a \$7,850 bill for lumber shipped to the owner's cottage be charged to the maintenance and repairs account. She had originally booked it to the shareholder account. The bookkeeper has also mentioned that the owner's spouse is on the payroll and has never been on the premises.



Discussion

- Very common owner managed business situation
- Possibly number one ethics issue for small CPA practitioners
- First questions, let us not assume wrong:
- Does the owner use the cottage for business?
- Re salary, it is possible that the spouse does work at other locations or from home
- For income tax, small spousal salary with a small amount of work is OK



The real issue

- If not a real business expense, financials are false if booked as an expense, should be booked to shareholder loan
- Also tax fraud if done wrong, you can't sign or be associated with the tax return
- Consider rule 205, 34 Quebec
- If you can T4 the owner for the benefit, it is OK, but should be reclassified to compensation for accounting



Owner discussion

- Owner may say “I can do exactly what I want with my money”
- You say “of course, as long as it is reported properly in the financials and tax return”
- Could tell owner that this will hurt, if the company is ever put up for sale, expenses look higher
- Rips off outside shareholders if owner is not 100%



Me in real life

- I hold the line on this, and some owners have not even pushed it, very respectful and ethical
- Owner: “May I take my wife (an active employee) on the business trip?”
- Me: “Sure, but we only charge it the company if she is working on the trip”, and he tells me if she is or isn’t
- Owner: “All my daughter’s cell phones are on the company plan, for better rates, but make sure you charge it my shareholder account”



Humour

- Tell owner the finance staff are coming to stay at your cottage, since it is a business expense
- I was a CRA auditor, I saw and heard of all kinds of funny things, eg entrepreneur deducting cost of daughter's expensive wedding as promo expense
- Owner tattooing name of their business on the bum of a horse, they race for a hobby, and write it off for tax purposes...
- Taxpayer "There was a flood in the area, my records got destroyed...Auditor response, if your records were under water, so was this whole city, and there is no record of flood in this area....
- The fudge audit...



Case

You are a financial analyst in the government and are responsible for the financial analysis for an important procurement decision. You have been told by your boss, the Director of Purchasing, that a decision has been made higher up that supplier A will win and your analysis should support this. Your initial financial analysis tells you that Supplier B is clearly superior for the government.



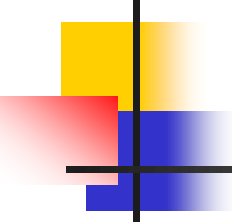
Analysis

- We all know there is a lot of procurement fraud in the government world
- Final decision is not the same as the analysis
- There may be qualitative swing factors
- Just play dumb and complete your analysis honestly and let the chips fall?
- Complete the analysis by noting items such as “I doubled this number without justification, because I was told supplier A must come out on top”



Analysis

- Refuse to do any analysis?
- Ultimately false & misleading issues
- Call the whistleblower line



Public sector procurement ethics story – a friend

- “I was given the responsibility for a -- project” (federal government)
- “My project evaluation team selected a small company ... This decision was a great disappointment to three of the largest -- companies in Canada”
- “These three companies....formed an unprecedented consortium”



Procurement ethics


- “The consortium’s proposal for the second phase was quite deficient in its technical aspects. Furthermore, their proposed cost was (way higher)”
- “My boss repeatedly gave the hint that I ought to follow the instruction given (*that consortium should win for political reasons*) I had no choice but to bring these distinctive differences to the attention of the --”



Procurement ethics

- “My big boss asked my supervisor to inform me that “he wants blood on the floor.”
- “Shortly afterwards, my big boss decreed that my Section would be closed and I got the notice to be transferred out of my job”

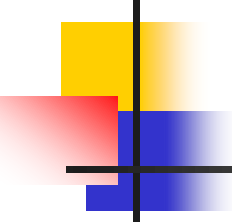
Procurement ethics

- “I went to talk to the lawyers of the Public Service Commission” (Whistleblower line of the time) 
- “After listening to what I told them in terms of what I went through, they were all too eager to take on my case in defending my rights”



Procurement ethics

- “Four years later my former big boss retired, and my former supervisor assumed his job.”
- “Very soon, I was really surprised to hear that my former supervisor was dismissed because of a sexual harassment allegation”
- **“The ADMTo my complete surprise ...personally called me and offered me the job of my former supervisor”**



Someone I know who interviewed in the public sector

- Job interview question: “the DM gets a bonus for spending less than X on _____. Would you book costs in the incorrect account, to ensure the DM gets their bonus?”
- His answer: No, I wouldn't
- Result: He did not get the job
- Conclusion: He is still not sure what they were looking for – an ethical person or a crooked accountant...



Case

You are the CFO of a private company owned by three siblings of the same family. Two are active in the business and one is not. The three shareholders are currently having a dispute. One shareholder who is active in the business asks you to join “her side”. The shareholder who is not active in the business, asks you for some financial information, other than year end information.



Analysis

- A not uncommon, but difficult situation, ethics is not the key issue
- You need to ask what she wants you to do specifically when on her side, so you can assess the situation
- Practically speaking, if you don't comply with the request and she wins the dispute, you may be out of a job
- Consult the shareholders' agreement
- Consider employer confidentiality and professional confidentiality and your job description
- Consult a lawyer



Conclusion

- Strictly speaking, under corporate law, the shareholder is not part of management or even an employee has no right to the information, unless approved by the Board, apart from the annual financials, which they are required to get
- If you can get all the parties to agree on the information disclosure, before providing it, you couldn't get in trouble
- Pragmatic solution, call the Mum: "your kids aren't getting along here, and I am caught in the middle, can you help?"



Analysis



Other comments

- I was once asked to come back to a former employer and help a family fight
- I declined
- A seminar attendee of mine was working for a family company, involved in possibly Canada's most active family dispute

Greg Sorbara in the middle of ugly feud that threatens family's billion-dollar company

By Will LeRoy — Toronto Star — Oct 5 2018



Four siblings, including Ontario's former finance minister, are locked in a bitter succession battle at the Sorbara Group. 'It's another situation where money poisons enduring family relationships,' Greg Sorbara says.



Case



- The CEO claims medical expenses not covered in her comp package, Chair of the Board has approved this, cheque is in the CFO's in-basket, CEO has signed it, waiting for 2nd signature
- What should the CFO do?



Analysis



- Play dumb: To Board chair: did your assistant miss this?
- Did the Board just amend her comp package without telling me?
- You could charge to loan CEO
- You could T4 the CEO if taxable, but this doesn't take away the comp problem



Note

- “Playing dumb” allows the person not be embarrassed about their error possibly unethical person or to be beat a graceful retreat, rather than getting defensive and fighting you if they were in fact unethical....



Recommendation



- Ultimately, can't sign. Don't break company policy

Creative solution



- He prepared his own fake policy-breaking claim
- She refused it
- He reminded her of her claim
- She tore it up
- CEO's hypocrisy revealed, she realized she was being unethical, problem solved without a word.
- Lesson: Sometimes there is a creative solution, although there are risks.



Notes

- To protect myself in a case like this, I would send an email to a colleague beforehand, saying my expense claim is not real, it is a test...in case she approved my claim...



A difficult situation

- CPA finds one partner ripping off the other business partner
- CPA found a way to get it to come up and be revealed in a meeting with both partners, so they had to deal with it, rather than just pointing the finger at the guilty partner



Last case

- You recognize there is an opportunity to take \$6.3 million from your employer and you are certain you can cover your tracks, so no one will ever know
- What do you do?



Analysis

- In basically all the scenarios so far, you are under pressure from others. Here is a personal temptation situation, that doesn't involve any one else
- Obviously you cannot even contemplate doing it
- Clearly, there are control weaknesses
- You need to put some controls in place so your successor can't be in a position to do this!



Note

- Only about 3 years of my career in total have been very ethically challenged ...we just had a lot of stories on them in this part of the seminar
- Avoiding unethical employers/bosses is covered in my **Practical Tips for Controllers & CFOs** seminar, as well as some other ethics topics



Note

- I confess that I used to be somewhat unethical...
- For example
- “Finders keepers, losers weepers”
- But I reformed at 21
- I should have listened to my parents earlier....



Note

- Taking a stand is not easy, the human side is a huge issue
- Easier if you are 64 years old and your retirement savings are set
- Big 4 accounting firm partner's email to me, after resigning a position due to ethics: "we wish there were more CFOs like you" – the resigned as auditors...
- (They got me my next job...)



I hope you were listening carefully

- It is easy to do the right thing in a class room case when little is at stake



I hope you were listening carefully

- I would not want to read about you in the CPA disciplinary notices...



This CPA hear me speak on ethics for nearly 2 hours....

Notice of Temporary Suspension –

On October 21, 2019, the Chair of the Complaints Inquiry Committee (the CIC Chair) requested that the Registrar of the Chartered Professional Accountants of Alberta temporarily suspend the registration of Heather Swanson, a registrant of CPA Alberta who lives in Edmonton or St. Albert, Alberta, pending the outcome of proceedings under Part 5 of the *Chartered Professional Accountants Act*, S.A. 2014, c. C-10.2.

On July 2, 2019, Ms. Swanson's registration as a member of CPA Alberta was cancelled due to non-payment of penalties. Due to the cancellation of Ms. Swanson's registration on July 2, 2019, her membership cannot be temporarily suspended as requested by the CIC Chair. Instead, the temporary suspension will be held in abeyance until such time that Ms. Swanson is reinstated as a member of CPA Alberta which at that time, the Registrar will immediately impose the temporary suspension requested by the CIC Chair as outlined above.



Do you have an ethics story,
you would like to share?



Past sharing

- “I found my CFO doing a fraud, I got him jailed”
- “I was told to cook the internal books of very, very famous Canadian company, with respect to internal reporting rules”
- “I questioned tax treatment of family payment by email and copied my gmail - I was fired within 30 minutes”



Some more ethical issues

- CFO invited audit team to cottage, to try get \$500K loss to become \$500K profit...CFO said a lot of auditors get “sued for putting client’s under”
- I tell a VP Sales and major shareholder, you can’t charge the company for your wife’s ticket on a business trip
- President donates shares of a private company at an exaggerated value for tax



Some more ethical issues

- The “water meter inspector’s” conscience bothers him....
- “Can you pick another sample”



Mandatory ethics PD hours

- This was 2 hours of verifiable ethics content
- I would be interested in a comparison and contrast of this ethics material with the any other ethics course you took here recently, email me



Quebec CPA note

- For reporting, you put in 2 hours in the field of professional ethics, the balance of hours in the field covered by the course in general



New ethics course

- **Ethics – More Than Just The Code**
- New course, that explores some Code of Conduct issues, but the right and wrong, even if not covered the Code of Conduct, the laws or contract
- 2 hour video, 2.5 hour webinar



Ethics – More Than Just The Code

- The rules/contract allow this - but is it right?
- Colleagues' actions and the association part of Rule 34
- Ethics problems between departments in the same organization
- Major Canadian CPA ethical lapses that are not well known
- The unreported revenue dilemma
- Will the auditors back you?
- Sanctions – should private companies punish players from certain countries?
- The subordinate who lies to you and the exaggerating colleague
- Ethics and blackmail
- Approaches to diffusing difficult situations
- All kinds of specific examples and stories



More ethics in my other courses

- **Practical Financial Negotiation Tips** – bribery and ethics in negotiations
- **Practical Tips for Controllers & CFOs**, avoiding unethical situations up front, other issues and more case situations
- **Practical Tips for NFP Financial Leaders**
- avoiding unethical situations up front, other issues and more case situations in an NPO context



Sleepiness test

- The first person who types “I am awake” wins a little prize

Other prizes in the in-class sessions...



Stop the tape, and take a nap,
I don't mind...

Stop the tape, and take a nap, I don't mind...



Foreign exchange management



Starting from basics

- If a company gets some foreign currency funds, how can it be turned into Canadian \$?
- Deposit in Canadian account
- Use bank's on-line system to sell
- Sell via bank's exchange desk
- Sell via an exchange broker*
- *often the best rate





Note

- I was told the bank's traders aren't commissioned, but they are bonused based on overall results



One broker



Joke on my trader, years ago

- Has money market (fixed income) desks of banks
- On April 1, I change his speed dial to the main bank to the police station!
- He is surprised and comes to see me to talk about it!





Foreign exchange risk mgt

- Foreign exchange means exchange risk
- Who faces exchange risks?
- U.S. dollar risk pervasive in Canada - do you face other currency risks?
- Our currency has the wrong name!
- F/X risk management is part of overall risk management



Foreign exchange risk mgt

- When the USD \approx the Canadian dollar, maybe we don't need hedge?
- Can you face exchange risk, even if you only transact only in Canadian dollars?
- If you are part of a corporate group
- Note: US companies are often oblivious concerning foreign currencies



Exchange case discussion

- What exchange risks are present?
- What is their approach to hedging?
- If you never buy or sell currency, and have currency flows are you naturally hedged?
- If you don't hedge you are saying either: we don't care about the risks or they are small or we are sure rates will only move in our favour



Complications

- I have had a President a few years ago, who said I am bullish on the Canadian dollar, we have petro-dollar and there is an oil boom, let's borrow in USD and not hedge
- He was right... for a while....



Can you forecast foreign exchange rates accurately?



Can you forecast foreign exchange rates accurately?

WARNING

CLICKING HERE IS FORBIDDEN



The Big Five bank's forecasts

USDCAD Forecasts (Canadian Dollars to 1 USD = Direct Quote Method)

Release Date		Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	2020 AVG
27-Nov-19	CIBC	1.3100	1.3300	1.3400	1.3600	1.3800	1.3525
31-Oct-19	TD	1.3100	1.3200	1.3100	1.3600	1.3000	1.3075
10-Oct-19	BNS	1.3000	1.2800	1.2800	1.2500	1.2500	1.2850
8-Nov-19	Royal	1.3000	1.3000	1.3100	1.3200	1.3300	1.3150
29-Nov-19	BMO	1.3240	1.3250	1.3170	1.3100	1.3020	1.3135
	Average	1.3088	1.3110	1.3114	1.3080	1.3124	1.3107



Or are they projections?!

USDCAD Forecasts (Canadian Dollars to 1 USD = Direct Quote Method)

Release Date		Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	2020 AVG
27-Nov-19	CIBC	1.3100	1.3300	1.3400	1.3600	1.3800	1.3525
31-Oct-19	TD	1.3100	1.3200	1.3100	1.3000	1.3000	1.3075
10-Oct-19	BNS	1.3000	1.2800	1.2800	1.2500	1.2500	1.2850
8-Nov-19	Royal	1.3000	1.3000	1.3100	1.3200	1.3300	1.3150
29-Nov-19	BMO	1.3240	1.3250	1.3170	1.3100	1.3020	1.3135
	Average	1.3088	1.3110	1.3114	1.3089	1.3124	1.3107

What is the only “rational approach”?

- All significant foreign exchange risks will be hedged when known



Foreign exchange risk mgt

- Do you hedge your foreign currency vacation risks like I do?





Suppose

- Your board/owner don't want to hedge, they view it as speculation or predicting rates
- Demonstrate the impact of exchange rates changes on your company if there is no hedging, and if there is



Foreign exchange

- Do you budget exchange rates?
- How?



Basic hedging with forwards

- Forward contracts allow one to buy or sell a currency for delivery on a specific future date at a specific price to take away risk. There is no fee to enter a forward contract
- \$1M USD coming in 60 days, enter a forward to sell \$1M in 60 days at a pre-determined rate



In the long, long run, should one hedge?

- No! But we live in the short run!



Sometimes there are
government accountants
taking this course



Does your government body hedge?

- One Maritime provincial government executive told me they hedge foreign exchange, and one from another province told me they don't...



An interesting new seminar I
have created

- **Practical Tips for Government Accountants**



An exchange joke

- A CPA said he overheard this, a lady interacting with a bank teller
- She said: "I need one thousand US dollars in cash"
- Teller said: "what denomination?"
- She said: "Florida"



Let's call an exchange broker
and check the market



One broker





Yes that was a real call

- Not like my Enron fake call..
- The call was recorded by the broker as well as me
- In all my years of market dealings we only once had to go back to the bank's recording to settle a dispute



Humour

- I have heard of a bank giving a bad quote
- They were actually giving the wrong side of market
- Buy when it was actually sell!



Foreign exchange risk mgt

- Where can you get exchange management advice?



Entering enter forwards

- What are the internal control implications?
- This is high risk because there is no immediate cash impact or accounting entry, so can get missed

Barings collapse at 20: How rogue trader Nick Leeson broke the bank

Twenty years ago, Nick Leeson caused the collapse of Barings, the City's oldest merchant bank and banker to the Queen

Nick Leeson on banking: extremely competitive ... and improperly policed



📷 Fugitive Nick Leeson is escorted upon arrival at Frankfurt airport, 2 March 1995. Photograph: Reuters



A smiling Jérôme Kerviel, accused of causing \$7.3 billion loss at French bank Société Générale, walks from prison yesterday with lawyer Elisabeth

BENOIT TES

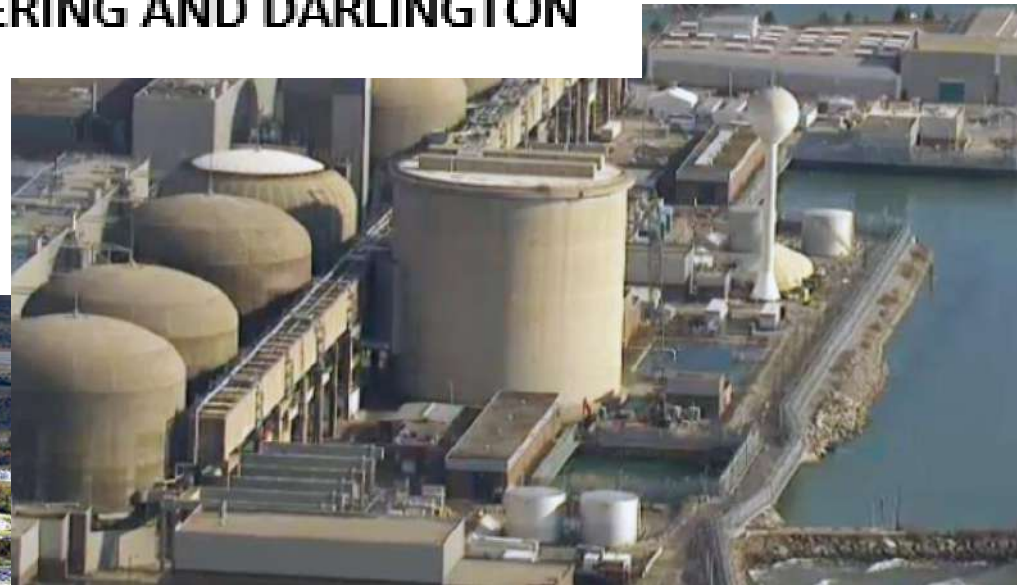
Name	Country	Date(s)	Loss	Institution	Market activity	Sentence
Jérôme Kerviel ^[5]	Paris, France	2006–2008	\$6.9 billion (€4.9 billion)	Société Générale	European Stock Index Futures	5 years prison of which 2 years are suspended, pending appeal
Yasuo Hamanaka ^[5]	Tokyo, Japan	1996	\$2.6 billion	Sumitomo Corporation	Copper	8 years prison
Kweku Adoboli ^[6]	London, United Kingdom ^[7]	2011	\$2.3 billion	UBS	S&P 500, DAX, and EuroStoxx Futures	7 years in prison
Nick Leeson ^[5]	United Kingdom	1995	\$1.3 billion (£827 million)	Barings Bank	Nikkei Index Futures	6.5 years prison
Toshihide Iguchi ^[5]	Osaka, Japan / New York City, United States	1995	\$1.1 billion	Resona Holdings	U.S. Treasury Bonds	4 years prison
John Rusnak ^[5]	Maryland, United States	2002	\$691 million	Allied Irish Banks	Foreign Exchange Options	7.5 years prison
Chen Jiulin	Singapore	2005	\$550 million	China Aviation Oil	Jet Fuel Futures	4 years and 3 months prison
David Bullen Luke Duffy Vince Ficarra Gianni Gray	Melbourne, Australia	2003–2004	\$187 million (A\$360 million)	National Australia Bank	Foreign Exchange Options	3 years and 8 months prison 2 years and 5 months prison 2 years and 4 months prison 16 months prison
Matthew Taylor ^[8]	United States	2007	\$118 million	Goldman Sachs	S&P 500 e-mini Futures	9 Months Prison ^[9]
Joseph Jett	United States	1994	\$74.6 million	Kidder, Peabody & Co	US Treasury bonds.	banishing trading securities
Stephen Perkins	London, United Kingdom	2009	\$10 million	PVM Oil Futures	Brent Crude	barred from working as a trader & £72,000 fine

Just down the road from Toronto



Just down the road from Toronto

NUCLEAR POWER PLANTS – PICKERING AND DARLINGTON



QUESTION 4 (23 marks) (55 minutes)

Chartrand Plastics Limited (CPL or the company) is a public company, incorporated in 1956. CPL processes plastics for companies that manufacture plastic products for consumer and industrial uses. The company has enjoyed modest success over the years and its stock price has risen steadily. Revenue and net income for the last four years have averaged \$380 million and \$26 million respectively. Balance sheet assets total about \$240 million. CPL has always received a strong credit rating on its long-term debt. CPL has been audited for a number of years by Lawson and Mawson, Chartered Accountants.

At the August 1995 meeting of CPL's audit committee, the topic of derivatives came up. Derivatives can be defined as financial instruments that derive their value from some underlying asset or liability, such as a currency or a debt security. The committee members, aware that a number of organizations—including industrial corporations, banks, and municipalities—have been bankrupted by derivatives recently, grilled the treasurer on the company's use of such new instruments. Not satisfied with her answers regarding controls, the audit committee has requested that Lawson and Mawson be engaged to provide a report to the audit committee identifying weaknesses in, the management of and internal controls over, derivative transactions. The report should also provide recommendations for improvements.

You, CA, are responsible for the assignment and for drafting the report. You have met with the treasurer and her staff and have prepared the following notes.

1. The treasurer and vice-president of finance each report to CPL's president. The financial reporting department reports to the vice-president of finance. Derivatives operations are managed by the director of cash management and investments (the director), who has a staff of six people. The director is primarily responsible for derivatives strategy and reports to the treasurer. Two members of the director's staff are traders who execute money-market (fixed income) and derivative transactions. Two other members of the director's staff are involved in accounting for these transactions, and the remaining two are involved in banking/cash management. One of the traders has considerable derivatives experience from a large bank. The second trader is an accountant who recently received a promotion to the trader position and is learning on the job. The director's unit is operated as a profit centre for performance-evaluation purposes.
2. CPL enters into derivative transactions with various financial institutions. Examples include the following:
 - Interest-rate swaps require that CPL exchange floating-rate interest payments for fixed-rate payments for a defined term. This turns the company's floating (variable) rate borrowing into fixed-rate borrowing. Typically a ½% upfront fee is charged by the financial institution based on the principal amount of the swap.
 - Foreign-currency forward contracts require that CPL buy or sell foreign currency at specified rates and dates. These contracts are no-cost agreements that are used to hedge specified foreign-currency exposures resulting from foreign purchases and sales of goods.



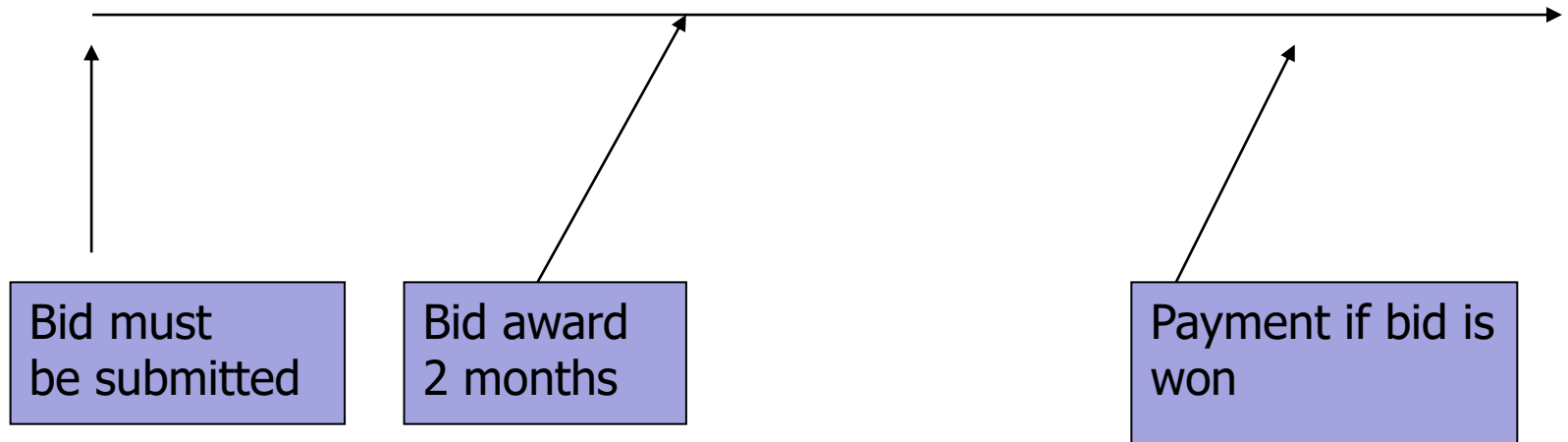
Hedging bids

- There is risk, but is hedging appropriate, before the deal is confirmed?
- Therefore, what should be done?



Bid diagram

- Bid amount: \$500K





Bid diagram

- Bid amount: \$500K

Bid: buy option to sell USD
at a specified rate, to protect
that rate

If win, enter US forward
to lock receipt of funds,
when they will be paid

Bid must
be submitted

Bid award
2 months

Payoff table, option to sell at \$1.31 – at bid award date

	Win bid	Lose bid
Rate above \$1.31	Let option expire, hedge at current (higher) rates	Let option expire
Rate below \$1.31	Make profit in market so no loss below \$1.31, hedge at current rates	Make profit in market so no loss below \$1.31



Currency option description

- Buy an American style option to sell USD at say \$1.31 during the bid period, giving you the option, not the requirement to sell the currency at this price, during the time period (or European, exercisable at the end of the period)
- You have effectively “locked” at least this rate
- If rate drops below on \$1.31, you make \$ in the market, whether you win or not, protecting your down side
- If the rate goes above option price, you let it expire, you have not lost out

Montreal Futures Exchange



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- » Margin requirements for futures contracts

Home » MX Products » Currency Derivatives » Options on the US Dollar (USX)

Options on the US Dollar (USX)

Underlying issues
U.S. Dollar.

Trading unit
One contract represents 10,000 U.S. Dollars.

Expiry cycle
At a minimum, the nearest three expiries plus the next two expiries in the designated quarterly cycle: March, June, September, December. Annual expiry of January for long term options.

Call	Bid price	Ask price	Last price	Impl. vol.	Open int.	Vol.	Strike	Put	Bid price	Ask price	Last price	Impl. vol.	Open int.	Vol.
Dec 16, 2016	34.13	34.19	34.38	--	3	0	100.00	Dec 16, 2016	0	0.07	0.07	--	0	0
Jan 20, 2017	34.05	34.11	34.30	--	0	0	100.00	Jan 20, 2017	0	0.07	0.07	--	0	0
Dec 16, 2016	29.13	29.19	29.38	--	0	0	105.00	Dec 16, 2016	0	0.07	0.07	--	0	0
Jan 20, 2017	29.06	29.12	29.31	--	0	0	105.00	Jan 20, 2017	0	0.07	0.07	--	0	0
Dec 16, 2016	24.13	24.19	24.38	--	0	0	110.00	Dec 16, 2016	0	0.07	0.07	--	0	0
Jan 20, 2017	24.06	24.12	24.31	--	0	0	110.00	Jan 20, 2017	0	0.07	0.07	--	0	0
Dec 16, 2016	19.13	19.19	19.38	--	0	0	115.00	Dec 16, 2016	0	0.07	0.07	--	225	0
Jan 20, 2017	19.06	19.12	19.31	--	0	0	115.00	Jan 20, 2017	0	0.07	0.07	--	0	0
Dec 16, 2016	16.63	16.69	16.88	--	0	0	117.50	Dec 16, 2016	0	0.07	0.07	--	0	0
Jan 20, 2017	16.56	16.62	16.81	--	0	0	117.50	Jan 20, 2017	0	0.07	0.07	--	0	0
Dec 16, 2016	14.13	14.19	14.38	--	0	0	120.00	Dec 16, 2016	0	0.07	0.07	--	975	0
Jan 20, 2017	14.06	14.12	14.31	--	0	0	120.00	Jan 20, 2017	0	0.07	0.07	--	0	0
Dec 16, 2016	11.63	11.69	11.88	--	0	0	122.50	Dec 16, 2016	0	0.07	0.07	--	0	0
Jan 20, 2017	11.57	11.63	11.82	--	0	0	122.50	Jan 20, 2017	0	0.07	0.07	--	454	0
Dec 16, 2016	11.13	11.19	11.38	--	0	0	123.00	Dec 16, 2016	0	0.07	0.07	--	0	0
Dec 16, 2016	10.63	10.69	10.88	--	0	0	123.50	Dec 16, 2016	0	0.07	0.07	--	0	0
Dec 16, 2016	10.13	10.19	10.38	--	0	0	124.00	Dec 16, 2016	0	0.07	0.07	--	2	0

YOU CAN PAY \$7 PER 10,000 TO BE ABLE TO SELL USD AT 1.265 ON JAN 20

TO PROTECT ONE MILLION DOLLARS, IT WILL COST \$7,000

Dec 16, 2016	8.14	8.20	8.39	--	0	0	126.00	Dec 16, 2016	0	0.07	0.07	--	0	0
Dec 16, 2016	7.64	7.70	7.89	--	0	0	126.50	Dec 16, 2016	0	0.07	0.07	--	0	0
Jan 20, 2017	7.62	7.68	7.88	--	0	0	126.50	Jan 20, 2017	0.02	0.08	0.10	--	0	0
Dec 16, 2016	7.14	7.20	7.40	--	0	0	127.00	Dec 16, 2016	0	0.07	0.07	--	0	0
Jan 20, 2017	7.14	7.20	7.40	--	0	0	127.00	Jan 20, 2017	0.05	0.11	0.12	--	0	0



By the way

- I never think in terms of the USD is .7443, but 1.3435



Back to the case facts

- You need to advise the company
- Big picture
- The company's core competence and business is making money, developing and selling networking gear, not speculating on exchange markets
- Speculating on exchange markets is highly risky and specialized
- This same logic applies to your employer...



Back to the case facts

- They should stop hedging occasionally based on feelings which is speculating really and put a policy in place which should probably be:
- All significant foreign exchange risks will be hedged when known
- They need to decide what is significant for them (material)
- The board should probably approve this



Mechanics

- RGC should proceed to hedge its current receivables and payables with forward contracts
- For the Halls Gear A/R and the Future Electronics A/P, because there is a natural hedge between payables and receivables of almost the same amounts and the same date, no forward would be needed
- Because the company's customers usually pay on time, it will be easier to use forwards
- If the customer does not pay on time, the company is still better off than if it was not hedged at all, smaller time risk



Mechanics

- The company could enter into forward agreement with a window to sell currency, rather than a specific date, for example, a forward to buy U.S. currency during the month of January 2010, for \$44,785, since payment of the Fabview Shop payable is being delayed
- The rate for these forwards may be slightly less favourable than a regular forward contract
- This is also called an option-dated forward
- The forward that is meant to cover the Jan 11 receipt from Tofino Corp, matures January 10, actually a day early, perhaps due to customer slippage



Note

- For some currencies, there is no forward market with the Canadian \$
- (not in this case)



Practice

- The company should try not sell to Canadian customers in U.S. dollars to reduce its exchange risks.
- There may be hidden distortions to this type of selling if the Canadian customer is hedging their purchase risk, although Rocky Gear may not know about this. In some cases, the customer may be trying to create its own natural hedges
- However: it may not be practical to just tell the sales dept: “don’t sell in USD”
- I have sold to Canadian customers just down the road in USD, this annoyed me, it seemed to be unnecessary exchange risk...



Spot

- The Accounting Manager's approach to converting US currency at spot is speculation to a certain extent. Balances should be converted immediately
- The rate could just as well move against the company
- The company should obviously get a US dollar bank account



Getting the best quote

- It may be useful to set up a spreadsheet that compares amount, rates quoted and transaction cost differences, if any, to pick a bid winner
- If a third party bank wins the bid, it may be necessary to wire the money at a cost, that needs to be considered



Getting the best quote

- It may be useful to set up a spreadsheet that compares amount, rates quoted and transaction cost differences, if any, to pick a bid winner
- If a third party bank wins the bid, it may be necessary to wire the money at a cost, that needs to be considered

CURRENCY BID SHEET					
Amount	400,000.00	Currency	US	Transaction	Sell
Institution	Rate	Trans cost	Net	Winner	
RB	1.2268		490,708.00		
TD	1.2270		490,796.00	X	
Broker X	1.2268	\$25 wire	490,711.00		
Note: Tie goes to our banker					



Banking angles

- Forwards give the bank risk and will normally tie up a portion of the company's bank line. Most banks use a formula that considers the volatility of the currency and the time frame. The amounts are more in the 4-15% range, and RGC does have fairly limited bank credit
- Export Development Canada can assist with margin requirements, for companies that export
- If a company doesn't have a bank line, cash margin deposits may be required, based on a risk formula
- I have had margin calls a few times in real life, where I ran out of credit, due to large currency movements...



Banking risk

- Practically speaking, bank credit risk is not a big issue, but broker risk is an issue
- The large banks in Canada are stable and relatively strong
- If one enters a bunch of forward contracts, chances are some will go up in value and some will go down in value
- The entire principal amount is not at risk, just the “in the money” parts



Controls here

- Currently, the accounting manager can phone the bank and enter into a forward contract verbally. This commitment is not immediately evidenced in the company. This commitment could damage the company and the company may not even be aware of the transaction, it doesn't get controlled and recorded immediately the way for example, cheque signing is controlled
- The company does not currently have a list of forwards contracts it has currently entered into, because the forwards are found here and there in files



Procedures

- When I took over foreign exchange at the large company
- I said “where is the list of the current forwards”, and there wasn’t one
- I put a listing in place and “marked it to market”



Procedures

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- I said “where is the list of the current forwards”, and there wasn’t one
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Forward listing		Current rate	1.3264					
<u>Amount</u>	<u>Currency</u>	<u>Maturity</u>	<u>Inst</u>	<u>Buy</u>	<u>Sell</u>	<u>Rate</u>	<u>Yield</u>	<u>Marked to market</u>
224,500	USD	20-Dec-19	CMB	x		1.3257	297,611	175
80,000	USD	10-Jan-20	CMB		x	1.3261	106,086	-29
<u>76,000</u>	USD	10-Dec-19	CMB		x	1.3258	<u>100,759</u>	<u>-51</u>
<u>380,500</u>					Avg	1.3258	<u>504,456</u>	<u>95</u>



Controls to put in place

- Ensuring the bank has an approved list of who is authorized to enter into transactions
- Having all forwards approved by you, the Controller
- Having the bank immediately or send a ticket to an individual independent of the person who entered into the forward and is organizationally separate and send documentation on the transaction to this person (the “back office”)



Another alternative



American style option to sell USD at 1.31 during the bid period for say \$60K

American style option so that you can buy USD at say \$1.34, during the bid period also for \$60K

- You have spent nothing, \$60K in and out
- You have created a cost-less collar, which means you will get at least 1.31, but you have not upside if the market rate is above 1.34



One way to understand the collar is as follows

- Your house is worth about \$600K in a slightly volatile market
- You might need to pay \$20K to have the option of forcing a third party to buy your house for \$550K in the next year (protects your down side)
- The same third party might pay you \$20K to have the option to pick up your house for \$650K in the next year (takes away your upside)
- You spent and received \$20K, you have a no cost collar, which protects you from your house going below \$550K in the next year, although you can't realize more than \$650K, if it goes up

The quotes come in



Option Price Quote
\$599,795.44
Type: American
Currency: Sell USD
Strike: 1.2300
Expiry: 120 days
Rep: PD



Option- American

\$601,324.44

Strike: 1.2300 sell USD

Exp: 120 days

Deal: SL




Option
\$301,323.44
Type: American USD sell
Strike: 1.2300
Expiry: 120 days
Agent: JR

One day, a seminar trip to Toronto

Departing Flight Change Flight

Monday, June 17th, 2019 Ottawa, CA (YOW) - Toronto, CA (YYZ)

09:00	Non-stop - 1hr06m	10:06
Ottawa		Toronto (YYZ)

Economy - Basic -\$1.00

1 Adult


A reminder that your Economy Basic fare includes some restrictions.

[Details](#)

! Economy Basic is a restricted fare. [Learn More](#)

Return Flight Change Flight

Wednesday, June 19th, 2019 Toronto, CA (YYZ) - Ottawa, CA (YOW)

12:10	Non-stop - 1hr02m	13:12
Toronto (YYZ)		Ottawa

Economy - Basic -\$1.00

1 Adult

A reminder that your Economy Basic fare includes some restrictions.

[Details](#)

! Economy Basic is a restricted fare. [Learn More](#)

One day, a seminar trip to Toronto

Departing Flight [Change Flight](#)

Monday, June 17th, 2019 Ottawa, CA (YOW) - Toronto, CA (YYZ)

09:00	Non-stop - 1hr06m	10:06	Economy - Basic	\$163
Ottawa		Toronto (YYZ)	1 Adult	

A reminder that your Economy Basic fare includes some restrictions. [Details](#)

① Economy Basic is a restricted fare. [Learn More](#)

Return Flight [Change Flight](#)

Wednesday, June 19th, 2019 Toronto, CA (YYZ) - Ottawa, CA (YOW)

12:10	Non-stop - 1hr02m	13:12	Economy - Basic	\$145
Toronto (YYZ)		Ottawa	1 Adult	

A reminder that your Economy Basic fare includes some restrictions. [Details](#)

① Economy Basic is a restricted fare. [Learn More](#)

 **Cancel within 24 hours of purchase without penalty. You will receive a full refund if you change your mind. [Find out more](#)**

View price breakdown	1 adult
 Air Transportation Charges	-\$2.00
 Taxes, Fees and Charges	\$29.22
GRAND TOTAL - Canadian dollars <small>(Change currency)</small>	\$31.22



Higher level executive thinking

- Covered more in my two hour webinar, **Practical Work Solutions from Case Discussions**



In real life

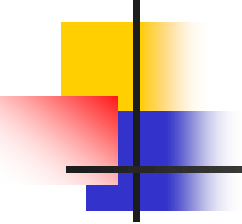
- We won the \$150M USD bid and had to enter into forwards to
- We got simultaneous quotes from 4 banks' exchange desk to get the best rate
- We actually “moved the Canada-US market price”, the moment we asked for the quotes, the only time I have done that...



There are sophisticated strategies out there for fixed exposures

- For example, a company is to be paid \$1M in 60 days
- They enter into a “participating forward”, where they get at least \$1.31 on receipt of payment, and if the rate is higher than \$1.31, they get 50% of the amount at the market rate
- (essentially they have an entered into a 50% forward, 50% option)

What is the bottom line?

- 
-
- Company decided to eliminate all down-side risk
 - But at the same time pay extra cash to get some upside, which may or may not happen and hard to quantify the cost benefit
 - Maybe they think they can predict exchange rates
 - On average they will lose due to the profit in the option pricing for the seller of the option

Other strategies to generally hedge



- (They don't specifically hedge, but reduce your overall risk)
- Most revenue are in USD
- Borrow in USD
- Increase USD costs



Once in my career

- We borrowed a lot of money in Lebanese Pound, unhedged
- Then there was a war in Lebanon
- But it did not devalue the loan for us, as the currency was pegged to the USD
- Therefore our only upside or exposure was Canada-US



You might want a Policy

It should address:

- Objective
- Typical exposures list
- General view on risk
- Procedure given different risks
- Instruments that can be used
- Natural hedging

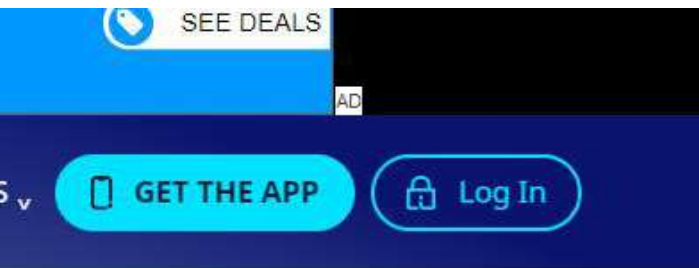


You might want a Policy

- Unusual situations
- Materiality
- Parties/banks that the company will deal with
- Limits for above
- Accounting
- Approvals and controls
- Budgeting

You can set up

- Warnings if rates reach certain levels on websites



Rate Alerts

Set your target rate and we will alert you once met



Note

- KYC (Know Your Client) is getting more and more strict in the banking sector and foreign exchange, particularly in Europe
- Small foreign sub's in Europe are viewed suspiciously, UK banks won't let us open an account...



Sleepiness test for you



Please read this aloud

**ONCE
UPON A
A TIME**



I bet you read it wrong

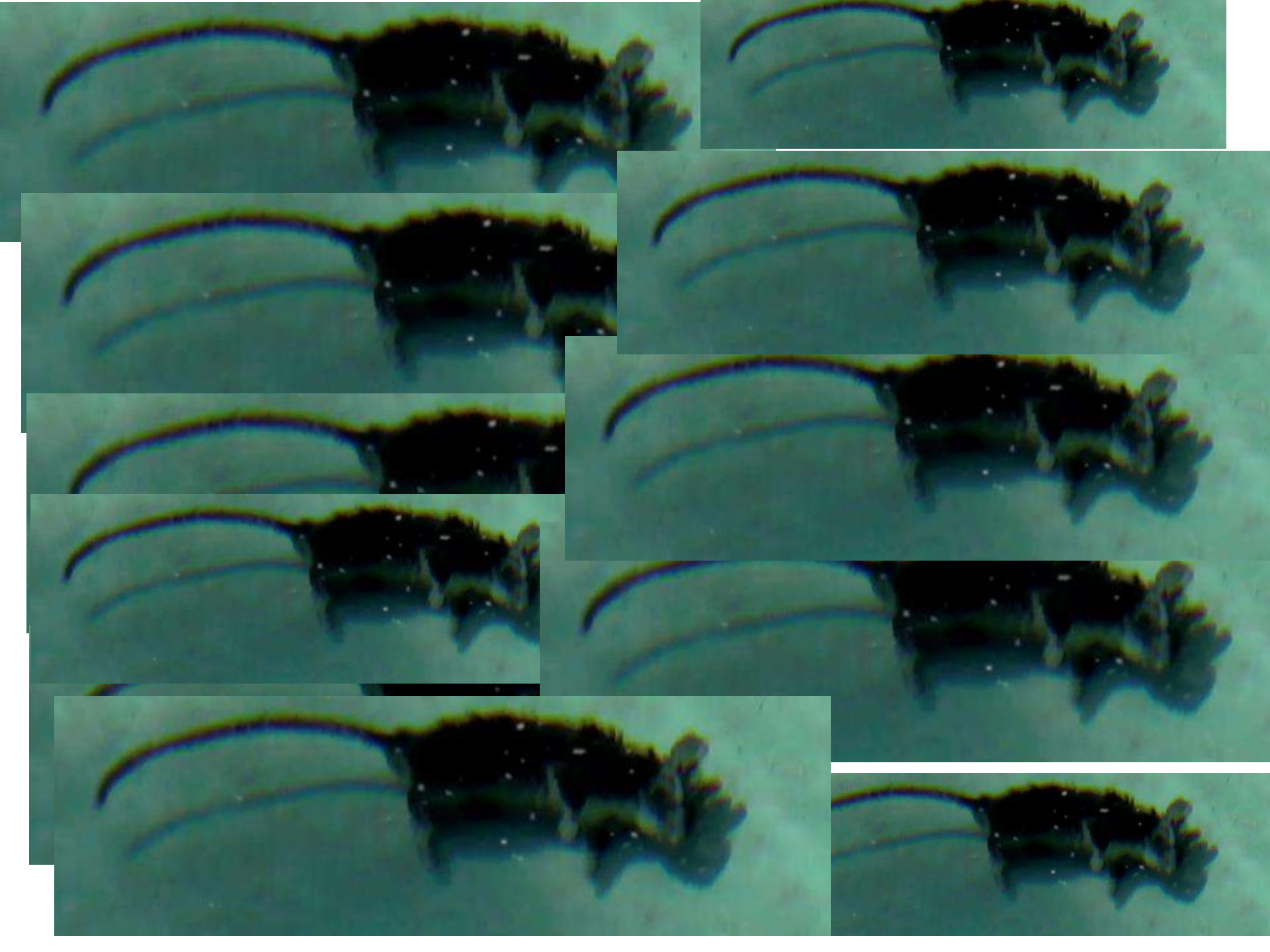
- Try again
- And again...
- In case you missed it...
- "A" was repeated twice, almost everybody misses it



Contracts

- We need a lawyer joke first







Note

- I don't actually want to kill all the lawyers....



Contract review

- Who is involved with contracts?
- A couple of high level comments on contracts:
- Someone wrote if you:
 - Can trust the other party, then you don't need a contract
 - Can't trust the other party, then the contract is nearly useless
 - But everything needs to be clear



Example

- Some CPA bodies don't bother with a contract with me for webinars/seminars/videos, they trust me, I trust them, we have worked together awhile
- However this did cause one problem when they didn't note a point in an email about pricing...



Policing contracts

- Many companies have rules like:
- *"All contracts must go through legal*
- *"All contracts must be reviewed by*

"
- This is fine, but it may not reduce business risks or control the organization entering into contracts



What do I mean?

- If a sales person does a PowerPoint presentation about what the company can do for the customer, and the customer says let's proceed with that deal, is this a morally binding arrangement that will go forward on these terms even if it is not a legally binding contract?
- And legal/____ may have never even heard of these deals!



Solution

- Being involved in the business and watching out for these kinds of arrangements/discussions, ensure they are within corporate parameters?



Contract review

- Do you always use a lawyer?

When reviewing:

- Ask a lot of “what ifs”
- Watch for key financial issues
- Watch for common sense legal and business issues

Some watch outs



- Track changes can be dangerous!
- Some examples
- Review on screen or on paper?



Former PM killed in Beirut blast



▲ People react at the site of a huge explosion in Beirut. Photograph: Joseph Barrak/Getty

Lebanon's former prime minister Rafik Hariri was killed today in a bomb attack on his motorcade in Beirut, the city which he was credited with rebuilding after the country's civil war.

At least nine other people, including several of Mr Hariri's bodyguards, were killed in the huge explosion at 12.55pm local time (1055 GMT) near the waterfront of the Lebanese capital, and some 100 people were injured.

Late



Note

- Even be careful with PDFs, (meta-data)
- The only sure way: re-type or print and scan...



Lawyer billing

- A lady went to see a lawyer for the first time...
- And said: "how much do you charge?"
- The lawyer answered...



Review this bill extract – your Canadian real estate company

<u>Hrs</u>	<u>Lawyer</u>	<u>Date</u>	<u>Matter</u>
5.5	Hazy	Nov 5	Closing, Marchisle Shopping Centre
.1	Palski	Nov 7	Crossing the street to say hi to client
.1	Palski	Nov 7	Finding out that it wasn't client
.7	Admin	Nov 9	Making photocopies
1.1	Admin	Nov 14	Verifying photocopies
6.2	Obama	Nov 22	Consulting with US attorney
17.1	Cartin	Nov 24	Research on Internet law in Latvia
5.1	Crook	Nov 28	Pre-closing work, 11 Fallow Street



Contract review – the case

- Make sure you understand the context of the agreement
- Remember to consider what is not there
- Will provide some contract template sources in the handout
- A great site for real business contracts, not free: www.realdealdocs.com



REALDEALDOCS™
From America's Top Law Firms



Contract review

Seven areas to consider:

- Entity that is party to the contract
- Cash & credit, triggers
- Banking
- Termination
- Taxes, including withholding
- Risk, liability & indemnity
- Rights and ownership
- Business tactics & strategy



Read the contract case

- And think through how it could be improved...



The mystery clause

6. KRETKHIRCS

Ykouk rshall rbe asr rhornest ars ran
rakcckournant.

- Remove **k** and **r**



The mystery clause

6. ETHICS

- You shall be as honest as an accountant.



A few other thoughts

- You should have a standard contractor contract in your company, but it must be tailored to the situation
- Some search words when reviewing an electronic contract: payment, cash, invoice, damages, etc.



Up front business question

- Are there are any strategic or tactical reasons why we are using an independent contractor like this?
- Should we not use employees, which is better in the long run, should we switch this person to a part-time or full-time employee?



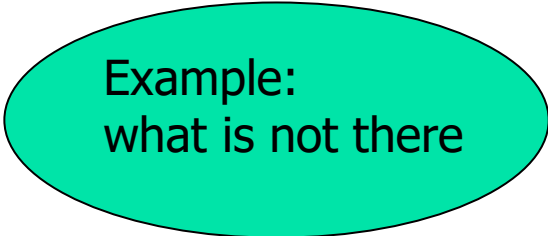
Contract signing

- Is there a need to initial corner of the contract? no, but safer
- Is there a need for it to be witnessed? no, but a little safer
- I do a lot of electronic contract signing, usually just pdf, not DocuSign or the more secure systems
- I am waiting for the first electronic signature lawsuit somewhere, I haven't heard of one
- "You signed this contract"
- "No I didn't you faked my electronic signature.."



Quebec only

- Put in: The parties have expressly requested and required that this Agreement and all other related documents be **drawn up in the English** language. *Les parties conviennent et exigent expressement que ce Contrat et tous les documents qui s'y rapportent soient rédigés en anglais.*



Example:
what is not there



Start and works orders

- The contract needs a start date and possibly and end date (see termination clause discussion later)
- May it needs a renewal clause
- Work orders will actually drive this whole contract
- Sample work orders should be reviewed, since they are key

Example:
what is not there

Example:
what is there

Commission clause

- The commission clause is highly unclear
- Suppose the consultant brings some new business, in conjunction with a Larkman sales person, is there a split?
- How long will commissions be paid, is it just the job they bring in, or all future revenues from the client or for a defined period?
- Is the commission based on revenue or signings or billings?
- When will the commission get paid? (it would be best if they are paid only when Larkman collects from the end customer)



Non-solicitation clause

- The contract really needs a **non-solicitation clause**, because the contractor could take business away from Larkman. An example would be as follows:

NON-SOLICITATION

You acknowledge that in consideration of your engagement by the Corporation pursuant to this letter and for a period of ninety (90) days after termination you shall not, directly or indirectly solicit, entice away or divert from the Corporation or provide work or services to:

- a) any of the customers or clients of the Corporation to whom you provided work during your engagement; or*
- b) or any employee, former employee, independent contractor or Consultant of the Corporation.*



An interesting non-solicitation situation

- My friend quits his sales job in an industry and takes another sales job in the same industry
- His LinkedIn automatically tells his connections he has changed jobs
- His former employer sues him for soliciting their clients, against his contractual non-solicitation clause
- After some nasty battling, he settles the action by shutting his LinkedIn down for a year



Employee or contractor

- You want it be very clear that the consultant is not an employee, so you are less likely to run into employment law issues, so the contract should state this
- You don't want to get hit with their EI, CPP, employer contributions, missed tax, late penalties etc, if they are found to be an employee later
- Generally for income tax and employment law purposes, it is a question of fact, whether the individual is an employee or an independent contractor

A possible clause to deal with this would be:



- *Nothing contained in this letter and the relationship created between us shall, directly or indirectly, constitute you as agent or employee or servant of Corporation and further, nothing herein shall operate or be construed to relieve you of any duties or obligations imposed upon you as an independent contractor. You covenant and agree to indemnify the Corporation and save it harmless from and against all liabilities and claims whatsoever against the Corporation, including fines, penalties and interest thereon, for or by reason of or in any way arising out of its failure to deduct, withhold or contribute any amount in respect of its payments to you pursuant to this letter. Such liabilities and claims shall include, without limiting the generality of the foregoing, federal or provincial income taxes, excise tax, GST, HST, QST, federal or provincial pension plan contributions, unemployment insurance premiums and contributions under any federal or provincial social insurance or income security programs.*



The tests, which we won't go into detail on

- Federal tests: integration, control, tools and risk of profit/loss
- Quebec test are similar, but there are six tests: financial liability, ownership of tools, the degree to which your work is integral to the activities of your work provider, whether your work ends upon achieving a specific result, the agreement between the person and the work provider



A big tip on this area

- Most CPAs are surprised by it, in my sessions
- A simple way to take the issue of the table



The tip

- Tell your one person contractors to incorporate
- Your company contracts with the corporation
- You may have to pay them 2-3% more to cover admin and tax prep costs they incur



We get audited for contractors

- We have about 20 contractors
- CRA reviews about 15, questioning whether they are really employees
- In the end they agree with my treatment



Exclusivity & non-comp

- Whether Larkman wants the exclusive services of the contractor is not dealt with
- Can the consultant compete with Larkman, between work orders?

Insurance

- If the consultant is doing anything with liability or professional risks, it is a good idea to require the contractor to provide liability and/or errors & omissions (professional liability) insurance and proof thereof
- However, practically speaking such risks are lower in an advertising agency arrangement
- In addition, it is often difficult for individuals to find this kind of insurance cover

It is more important in construction and riskier work





Compliance

- Compliance with Larkman's and Larkman's customers' codes of conduct/ethics, harassment policies etc, should be addressed, and which one supersedes if there a contradiction
- The contractor should know that bribes are not acceptable
- Even dress and comportment at customer sites could be set out, if desired
- A clause that says the contractor will comply the company's Privacy Policy and all applicable privacy laws may be advisable



Rights and ownership

- A very important area
- We want to clearly own any intellectual property they create while under contract with us
- A clause like this would help:
- *Ownership of Property. All reports, plans, written proposals, and all other business information or products relating to the Corporation or its customers, prepared or produced by the Consultant in connection with the performance of Consultant's obligations hereunder shall be and remain the exclusive property of the Corporation.*



GST/HST/QST

- It should be clear that this is not in the hourly rate
- Note, I have had consultants naively bill taxes when they are not registered
- I say, “look, you better not do that, you could get yourself in big trouble....” and they appreciate the tip

A great tip to help your contractors



- Tell them about the method that nobody seems to know about, to make money from GST-HST-QST



Quick Method, Quebec, service business

- Example, \$100,000 billings
- Charge \$5,000 GST
- Remit 3.6% of \$113,000, less \$300* = \$3,480
- Charge QST of \$9,975
- Remit 6.6% of \$109,975, less \$314.21* = \$6,350.28
- Therefore "Profit" \$5,144.73 less any unclaimable ITC's

*1% special rule

Some other tips to help your contractors



- Have a small accounting firm tax specialist advise them about income tax issues in your office
- Have a broker for 1-2 person benefit plans meet with them in your office to advise



Quality control/performance evaluation

- It is not clear who the consultant reports to organizationally, within Larkman, this could be clarified
- Although they might be hard to define, some quality of work criteria should perhaps be set out in the agreement, for further clarification
- For example, if the end customer doesn't like the consultant's work that should result in contractual implications, including termination
- Is there some kind of performance evaluation feedback loop?
- There is no requirement that the work orders get approved by a particular manager in Larkman, prior to payment?



Termination clause

- The contract does not have an end date, or a clear termination clause
- We would want to terminate the consultant easily if anything goes wrong
- Having said that, if there is no current work order, the consultant will not be doing any work
- An annual renewal clause would allow Larkman to refresh the terms
- The clause should also require the contractor to return any Larkman or customer materials, documents, etc., upon termination



Authority

- It might be a good idea to specify to what extent the contractor can represent and bind the company
- I have had contractors that I wanted to bind the company (contract engineer procuring materials) and some I don't want to (eg contract entry clerk)
- Is the contractor an agent of the company?



Confidentiality/non-disclosure

- The contract is missing a non-disclosure confidential information clause
- The consultant could be handling sensitive information and should be bound not to disclose it
- Legal advice should be sought on a strong clause that is appropriate



Location, tools, expenses

- The contract doesn't address where the work should be carried out (our office/client office/home office, variable)
- Will they get an office or cubicle at Larkman's premises
- The contract should be clear if the consultant will get reimbursed for items such as travel expenses, and at what rate
- The contract should address the issue of who provides the tools and equipment the consultant is going to use, does he/she have to provide some of his/her own, e.g. a laptop, software cell phone, etc
- The results of this could impact the employee versus contractor classification



Other - financial

- If there are no minimum hours, this should be clear
- Larkman may want an hours cap in the contract
- Payment terms in the draft contract are “on a timely basis” - this is unclear Some clearly defined term like 30 days, would be more appropriate
- Consideration could be given to charges of interest on late amounts, but this would normally be in favour of the contractor, so you might not want to raise it
- We don't know if the individual is in fact a non-resident, which could have a number of tax and other implications, so this could be covered



Other - financial

- Worker Compensation laws vary by province, but you want a clause that deals with the responsibility for this, after consulting the applicable laws
- It would be best if the records retention period, was the same as the requirement for income taxes
- If ever the consultant owes the company money, it is better if there is a clause that lets the company deduct this from amounts owed by Larkman to the consultant (set-off clause)
- Currency not specified, it is best if it is
- Invoicing frequency should be specified, the slower the better for us



Other

- The enurement clause is probably too harsh and unrealistic, the consultant's heirs will not be responsible for services under the agreement!
- A clause that keeps Larkman free from the responsibility for the contractor's errors, would be useful and safer for the company (hold harmless)
- You might want a list of definitions



Other

- The generic clause, “this contract represents the entire agreement and any pre-signing oral discussions are not valid” is probably advisable
- The contract should be clear that the consultant cannot sub out any of the responsibilities, nor can the contract be assigned to anyone else.
- It is good to have a dispute resolution clause that goes to arbitration or mediation first, before an acceptable authority



Applicable law

- The consultant wants the **laws of Quebec** to apply
- If your company is not in Quebec, Quebec laws are somewhat different than the laws in the rest of Canada, so you would like the laws of your province to apply



Note

- Now that we have dramatically improved the contract, we could take it to the lawyer for a 15 minute review they can turn around in two days
- Instead of 4 hours... turned around in a week...



Job interviews



Job interviews

- You have been interviewed for jobs, you will be interviewed in the future, and you may be interviewing others
- (Please follow all internal rules with respect to interviewing)

My two worst interviews...



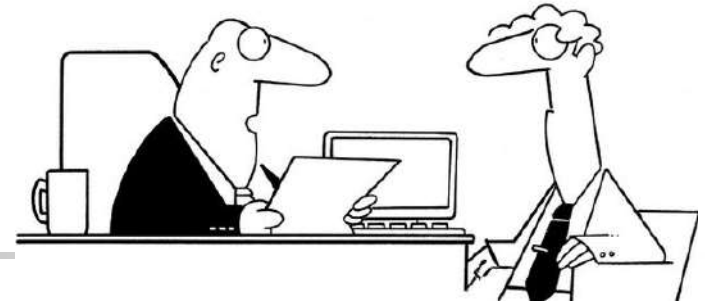
My two worst interviews...



Proverb: A fool's lips walk into a fight...

The most important interview I ever gave

Job interviews



- Who interviews accountants?
- We want to hire good people
- I have surveyed 1,300 financial executives on the biggest trouble spots at work
- Most of the largest trouble spots ultimately related to people issues



Google people

- What's your most interesting google finding when you googled someone?
- Once it results in a common interest, that resulted in me hiring my successor...

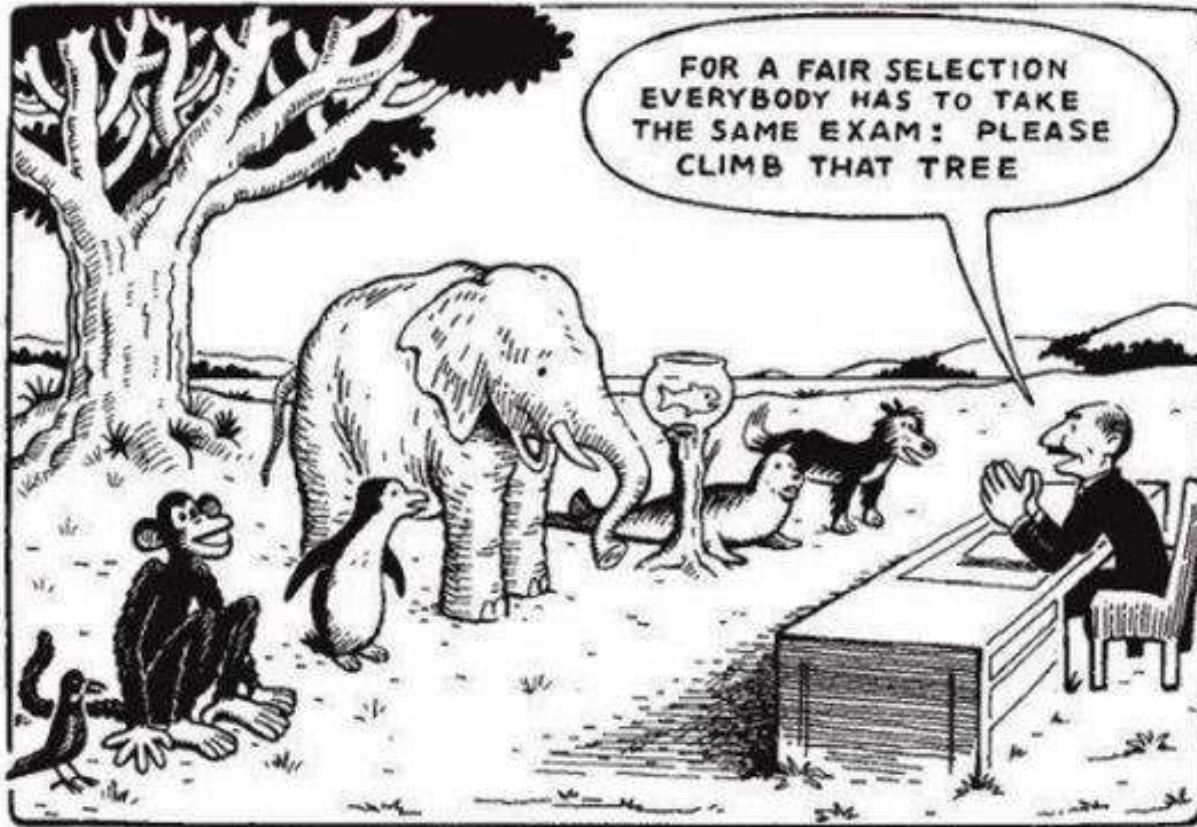


We want to hire responsible
people with initiative...

It's not my job!



Interviewing - consistency





Someone once said

- “Hire slow, fire fast”
- Be careful who you hire, but then if they are terrible, don’t suffer too long, deal with them
- Too many times in business, I have heard: “we should have got rid of that person a lot earlier”



Interviews - eyes

A course apparently teaches that:

- Eyes looking up – lying
- Eyes side to side – truth
- The result in one family
- I also think handwriting analysis to predict anything is hoky-poky



Interview stories

- Worst interview question I heard of
- When eating a meal as a job interview (2 stories)
- The Irving interview
- What weaknesses should you disclose?
- I know an experienced NS businessman, won't hire people if they starting asking about money
- How your resume could get attention



Funny millennial job interview



Comments

- I know you and your kids are not like this
- But I know there is some truth in this, both the parents and the kid!
- The solution to the lazy millennial, check out a big tip in **Practical Brain-Storming – Top Ten Trouble Spots and other Useful Topics For Financial Leaders**



Interview ideas

- Not just general questions, but get specific, give them cases (the funny answer) (the funny answer....) "*I would execute flawlessly*"
- You say you know this system so...actually do something on it in front of me
- You say you know Excel so...set up a spreadsheet that
- Test grade 9 math: Commutative property
- Is $(a + b) * 9$ the same as $a+b*9$?



Check references of course

- Watch out for fake references!

If you are able:

- Ask around, we are all connected
- The rule of two

Watch out for fake references:

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URGENT UPDATE : Contact number for texting Jennifer Hatton has been updated to 614-418-1724

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see your references **BEFORE YOU BUY!**
(NO commitment required)

Gap in Resume?
Bad Job References?
Too Many Part-Time Jobs?
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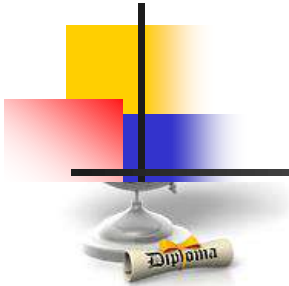
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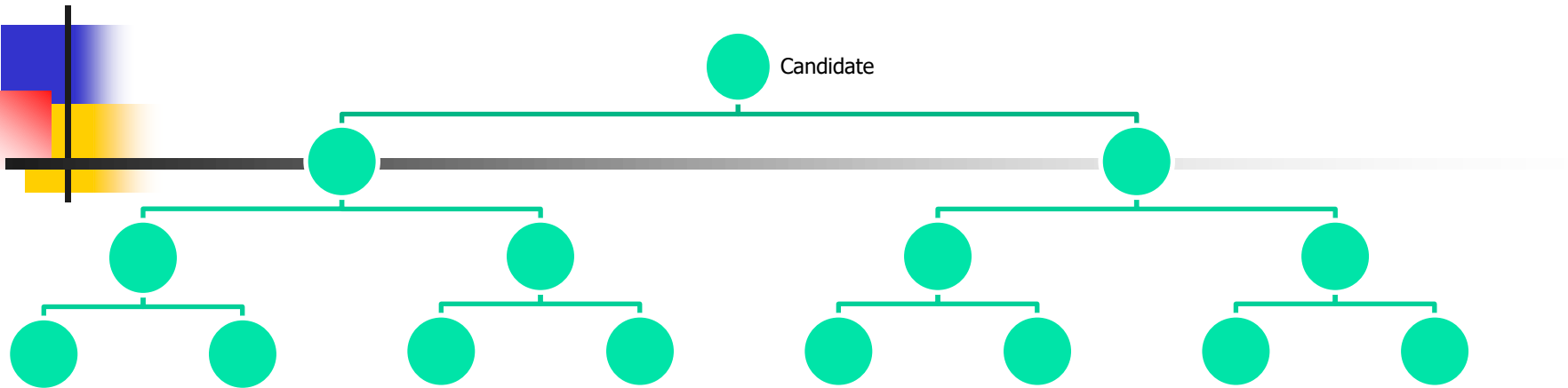




The rule of two

- Ask the two given references, for the names of two more people who know the person, and then do this again
- You are two steps removed from the biased first given references
- These 12 people may give you useful information, they may decline to discuss...

Ask for two more references twice...





Would you give an indirect reference, you didn't volunteer

- If enthused about the person, likely
- If you were not keen on the person, you won't say bad things about them
- But the reference checker will be able to tell from what you answer

Job interviews

- Some general interview tips:
- Ask impossible to answer questions and see how they answer
- Make them feel good – idea _____





Job interviews

- Some general interview tips:
- You must always google them
- Ask impossible to answer questions and see how they answer
- Make them feel good – idea reimbursement of even small travel expenses to the interview



Job interviews

- How to get the critical information you need
- You don't want to lead the candidate too much so they tell you what you want to hear
- The more you get them talking, the more you will learn (a lunch is good)
- What if the candidate hesitates and there is a period of silence? Wait, say nothing



Notes

- Some people believe stories in the past tense by an interview are true, the present tense are not



Scenario

- You are looking for an accountant, who is a very strong team player because of all the different types of project work



I suggest you don't ask:

- *Are you a team player?*
- *Give me examples of when you have been a good team player*



I suggest you ask

- *Describe the kind of a job you would like least*
- *Describe a time or a situation at work where you felt it was necessary to modify or change your actions in order to respond to the needs of another person?*
- *What is the biggest work mistake you have ever made and what did you learn from it?*



I suggest you ask

- *What did you like most about your last job?*
- *What do you not like about working with other people?*
- *Describe some projects you worked on in your last job*



I suggest you ask

- *If you were given \$2,000 for team-building activities, how would you spend it?*
- *Give an example where you worked with a group in a previous employer to accomplish a goal*



Note

- Perhaps whether they use a lot of “I”, versus “we”, may have bearing on whether they are a good team player



Tips

- Get them to elaborate:
 - Perhaps you could clarify what you mean by that?
 - I would like more of your thinking on that?
- Insist on specific answers and don't be shy to "say these statements contradict each other"
- If appropriate say: "could you give me the name of one person who could confirm that"



Scenario

- You are looking for an accountant, who:
 - Has the ability to work alone
 - Someone who will diligently follow procedures



I suggest you ask

- *Describe the kind of a job you would like least*
- *What did you like most about your last job?*
- *What conditions will make you successful?*
- *Describe a situation in your career where you were able to get things done faster*
- *What would you do if we had to cut certain corners to achieve company objectives quickly?*
- *What kind of procedure in a company do you find a pain to deal with?*



I suggest you ask

- *Describe the month end process in your last job*
- *Explain your role relative to your colleagues in your last job*



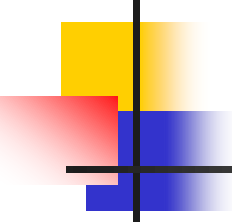
Some other useful interview questions

- *Why should we hire you?*
- *What do you tend to get stressed about at work?*
- *Name three people you admire and why you admire them*
- *Ask about life's choices and see what drives them*
- *If you were an animal, what would it be?**
- *What sports do you play?***Give me three adjectives to describe you*
- *Tell me of an incident where you carried the ball alone for a previous employer*



Some other useful interview questions

- *What do you do during coffee breaks?*
- *I know who I want for this position, how can you get me to change my mind?*
- *Have you ever "saved the day for your boss" ? If yes, describe the situation.*
- *If you were not going after this job, what would you be doing?*
- *What is the biggest work mistake you have ever made and what did you learn from it?*
- *If you were a tree, what would it be?**
- *What do you not like about supervising people?*



You will get additional sample questions with your completed slides.



Can you think of a better name for the course?

- Send me an email



Other courses of interest

- Sister course, nearly 10,000 have attended, different content, no long cases
- **Practical Tips for Controllers & CFOs** , full day
- Government version of this course **Practical Tips for Government Accountants** full day,
- NFP version of this course **Practical Tips for NFP Financial Leaders** full day



Other courses

- **Practical Financial Negotiation Tips**
half day
- **Practical Tips to Get Through a Cash Crisis** 2 hours
- **Practical Brain-Storming – Top Ten Trouble Spots and other Useful Topics For Financial Leaders** half day



Other courses

- **Practical Work Solutions from Case Discussions, 2 hours**
- **Practical Work Smarts for All 2 hours**
- **Ethics – More Than Just the Code 2 hour video, 2.5 hour webinar later**



Notes

- All courses available through CPA Quebec as webinars & videos

Heavy coverage ***	Practical Tips for Controllers & CFOs	Practical Tips for Controllers & CFOs - The Case Course	Practical Tips to Get Through a Cash Crisis	Practical Financial Negotiation Tips	Ten Practical Topics for Financial Leaders	Practical Work Smarts for All	Practical Tips for NFP Financial Leaders	Practical Tips for Government Accountants	Practical Work Solutions from Case Discussions	Ethics - More Than Just the Code of Conduct
Medium coverage **										
Light coverage *										
.										
Length	Full day	Full day	2 hours	Half day	Half day	2 hours	Full day	Full day	2 hours	2 hours
Humour	***	***	***	***	***	***	***	***	***	***
Business smarts	***	***	***	***	***	***	***	***	***	***
Improving financial reporting	**	***					***	**		
Bank negotiations	**	***	**	.			**			
Dealing with tight cash			***							
Negotiations	.	.	**	***	.	.	.	**	**	
Cost-saving	**	.	**		***		**			
People & management	.	.	.	**	**	***	.	**	**	
Creative thinking	***	.	.	**	.	.	***	***	.	.
KPIs	***	**					***	***		
Fast close	**	**					**	**		
Technology & systems	**					**	**	**	**	
Strategic thinking		**			***	
Lawyers & contracts	***	**		.			***	***		
SRED	**									
Taking a new job	***						***	***		
Ethics	***	***	.	.			***	***	.	***



Closing comments

- I hope to meet you one day at an in person course
- Was this boring?
- Send me an e-mail spriddle@bell.net, to get completed slides
- Do LinkedIn with me
- Please complete seminar evaluations

FINANCIAL REPORTING CASE SUGGESTED APPROACH

Note:

This is a suggested approach, not a “correct” approach and it does not necessarily represent the only way the case could be handled.

General

The monthly financial reporting for Bild Construction Inc. could be improved significantly. Currently it exhibits the following general weaknesses, as well as many specific weaknesses:

- Lack of sufficient, decision-oriented information
- A very weak written, uninformative analysis of the month’s results from the Accounting Manager
- Lacks useful schedules
- No looking ahead to the future, even though October is almost over

It is also important not to overload the Board/senior management with useless information.

It would be best to label the financials “unaudited”. Putting draft or preliminary can also be useful.

Management issues

There may be some management and personal career risk issues here. Are you getting into a mine field? There has been poor past reporting, uninformed senior management, jobs with losses and possibly other possible skeletons in the closet.

Narrative

Here is a possible improved monthly narrative.

Members of the Board and Executives,

October 23, 2019

You will find attached the September monthly report. We have expanded the reporting to provide more relevant information to the Executives and the Board.

It was a relatively good month for BCI sales as revenues were higher than Budget, primarily due to revenues earned on the \$1,610,00 C200 project signed in July, that was not anticipated in the Budget. There were 19 regular working days in the month, compared with 22 in August and 21 in October. This shows that regular working day was high. We will be updating the Budget shortly, to reflect the inclusion of the C200 project.

Revenues were for the month and the year were running 5.8% and 11.6% respectively, higher than the corresponding periods in 2018.

The key components of revenue are now set out in the report, graphically, as well as the monthly revenue trend for the year. The trend does show a decline after some very strong early months in the year. The decline should be explained.

The company's direct project margin year to date was lower than budgeted by 1.4% primarily due to the Wayly Plastics project. A new key project summary is found in the attached. On a weighted average basis, the projects are 3.7% under budget. The most risky project currently underway is the Wayly Plastics project. The risk relates to unanticipated soil problems. In the future, the company needs to consider ways to mitigate such risks. As seen in the attached, the project's costs are over-budget significantly. At this point in time, there are risks of penalty clauses being triggered.

Expenses were generally consistent with budget for the period. The large increase in professional fees, reported under General Administration was due to the receipt of an unexpectedly large bill from the firm's lawyers, with respect to the Rio Properties dispute. These fees will be monitored closely by BCI, until this matter is closed. We believe the \$164,000 Rio holdback is 100% collectible. If any Board members have industry contacts that could help in either of the Philips or Rio matters, please let me know.

I have noted that our contract win cost ratio, defined as variable sales & marketing costs divided by contract wins in dollars, has significantly improved over the prior year. It went from 27 to 1, to 34 to 1. This measure is not perfect, because some current costs will bring in future contracts, but I believe this represents a step forward in the business.

The bottom line for the month before taxes was \$54,269 and for the year, \$726,264. This represents 2.5% of revenues for the month and 4.6% year to date. This compares slightly favorably with a recently discovered industry average of 4% for BCI's sector. (Source: Construction Contractors Factbook, 2019). However, due primarily to higher General Admin costs, the month was less profitable than September 2018.

In terms of outlook, October is going to be a weaker month with about \$1.5 million of revenues, based on early results and a small loss will be reported. November and December revenues will likely be at the same level with small losses. As we move toward our December 31 year end, we believe the company has some chance of achieving the milestone of \$20 million in sales, for the first time in BCI's history. This is because year to date revenues plus three months at \$1.5 million give sales of \$19.985 million.

The company's cash position at September 30 was \$212,000 with no amount on the operating line. However, on October 12, 2019, under the terms of one of the company's contracts, the company was required to place \$68,000 in escrow with a third party lawyer, until certain conditions have been fulfilled. It is expected that the conditions will be fulfilled in early January. This will constrain the company's cash position in the near term. The sources and uses of cash in the month have been now set out in the Statement of Cashflow, similar to the one reported in the company's annual financial statements.

There is one old accounts receivable that is of concern, \$67,000 from Philips Limited. We ceased work entirely on the project, in an attempt to force the customer to pay. We will be reviewing legal alternatives in due course. An allowance for doubtful accounts of 50% of this amount has been provided.

The company's summary accounts receivable listing is set out in the attached, along with pie charts indicating the type of contract, currency and due date. There is currency risk in the company's

receivables since the company's position is not to hedge currency risks. The Board has no idea what the magnitude of the exchange risks faced is, at least this could be quantified. The Board might want to revisit the no hedging position in due course.

During the month, the company acquired a patent, related to a useful concrete construction technology and it is reported as an intangible asset in the balance sheet. The business reason for the purchase was _____. The cost of the patent will be amortized to income over 10 years, the approximate useful life. The legal life of the patent is 20 years. I will try to look into licensing the patent to third parties, so that it will generate additional income for BCI.

The company's share activity for the month is set out in a new note to the financials.

The company is on side with respect to all bank covenants, as now set out in the financial statements. However, the company's position relative to its minimum current ratio has deteriorated compared with August and it is close. We will be taking steps to improve this position over the next two months. I also need to check the treatment of the patent intangible asset in the debt-to-equity covenant from the bank. We have included the intangible in equity for this calculation, but the company would still be on side if it was excluded.

My statutory declaration is that all required source deductions were remitted on time in the month.

There is a summary of the company's business, financial history and critical accounting policies in a special attachment for our newest board member.

Please contact me if you have any questions about this report.

Yours sincerely,

New Controller

Statement of Operations								
2019								
		Budget	Variance		YTD		2018	2018
	September	September	Fav/(Unfav)	YTD	Budget	Variance	September	YTD
Revenues	1,828,632	1,611,667	216,965	15,486,865	14,505,000	981,865	1,728,001	13,878,851
Direct project costs	<u>1,444,619</u>	<u>1,256,028</u>	(188,591)	<u>12,281,084</u>	<u>11,304,255</u>	(976,829)	<u>1,375,489</u>	<u>10,978,171</u>
Margin	<u>384,013</u>	<u>355,638</u>	28,374	<u>3,205,781</u>	<u>3,200,745</u>	5,036	<u>352,512</u>	<u>2,900,680</u>
	21.0%	22.1%		20.7%	22.1%		20.4%	20.9%
Other costs								
Sales & marketing variable	51,072	57,825	6,754	464,752	520,428	55,676	50,125	481,458
Sales & marketing fixed	64,445	64,918	472	586,452	584,258	(2,194)	59,425	501,428
Rent	19,541	19,541	-	175,866	175,866	-	19,541	175,866
General administration	96,425	60,013	(36,412)	571,759	540,121	(31,638)	61,252	512,485
Miscellaneous	<u>84,525</u>	<u>66,556</u>	(17,969)	<u>591,675</u>	<u>599,000</u>	7,325	<u>64,525</u>	<u>547,582</u>
	<u>316,008</u>	<u>268,853</u>	(47,155)	<u>2,390,504</u>	<u>2,419,673</u>	29,169	<u>254,868</u>	<u>2,218,819</u>
Income/(loss) before interest amortization and taxes	68,005	86,786	(18,781)	815,277	781,072	34,205	97,644	681,861
Amortization	12,052	5,444	(6,608)	68,408	49,000	(19,408)	10,078	65,478
Interest & bank charges, net	<u>1,684</u>	<u>1,167</u>	(517)	<u>20,105</u>	<u>10,500</u>	(9,605)	<u>2,405</u>	<u>22,458</u>
	<u>13,736</u>	<u>6,611</u>	(7,125)	<u>88,513</u>	<u>59,500</u>	(29,013)	<u>12,483</u>	<u>87,936</u>
Net income before inc. taxes	54,269	80,175	(25,906)	726,764	721,572	5,192	85,161	593,925
Income taxes	13,784	20,364	(6,580)	184,598	183,279	1,319	21,631	150,857
Net inc. after tax	40,485	59,810	- 19,326	542,166	538,293	3,873	63,530	443,068
Income as a % of revenue	3.0%	5.0%		4.7%	5.0%		4.9%	4.3%

	Balance Sheet	
	30-Sep	31-Aug
	<u>2019</u>	<u>2019</u>
ASSETS		
<u>Current Assets</u>		
Cash	212,133	3,072
Trade accounts receivable (see listing , net of of an	1,399,969	1,348,474
Work-in-progress and other receivables	211,458	424,255
Prepaid expenses	<u>41,252</u>	<u>42,522</u>
	<u>1,864,812</u>	<u>1,818,323</u>
Property, plant & equipment	847,582	843,431
Intangible asset	29,748	-
TOTAL ASSETS	<u>\$ 2,742,142</u>	<u>\$ 2,661,754</u>
LIABILITIES & SHAREHOLDERS' EQUITY		
<u>Current Liabilities</u>		
Operating line of credit	-	100,000
Accounts payable & accrued liabilities	1,062,045	888,549
Deferred revenue	57,060	54,286
Current portion of term loan	<u>114,222</u>	<u>114,222</u>
	<u>1,219,543</u>	<u>1,157,057</u>
Term loan	568,865	645,232
SHAREHOLDERS' EQUITY		
Common shares (see note 1)	354,125	314,125
Retained earnings	<u>585,825</u>	<u>545,340</u>
	<u>953,734</u>	<u>859,465</u>
TOTAL LIABILITIES & EQUITY	<u>\$ 2,742,142</u>	<u>\$ 2,661,754</u>
<u>Bank ratios</u>		
Debt-to-equity (max 2.25)	1.88	2.10
CR (1.5 min)	1.53	1.57

	Cashflow	
	for the month of September	
Cash provided by (used in)		
OPERATING ACTIVITIES		
Net income/(loss)	40,485	
Amortization of property, plant & equipment	<u>12,052</u>	
	52,537	
Changes in non-cash operating working capital items:		
Trade accounts receivable	(51,495)	
Work-in-progress and other receivables	212,797	
Prepaid expenses	1,270	
Operating line of credit	(100,000)	
Accounts payable & accrued liabilities	173,496	
Deferred revenue	2,774	
Current portion of term loan	<u>-</u>	
	<u>291,379</u>	
INVESTING ACTIVITIES		
Purchase of property, plant & equipment	(16,203)	
Purchase of intangible asset	<u>(29,748)</u>	
	<u>(45,951)</u>	
FINANCING ACTIVITIES		
Term loan	(76,367)	
Issue of common shares	<u>40,000</u>	
	(36,367)	
Change in cash & cash equivalents	209,061	
Cash & cash equivalents, beginning of month	<u>3,072</u>	
Cash & cash equivalents, end of month	<u><u>212,133</u></u>	

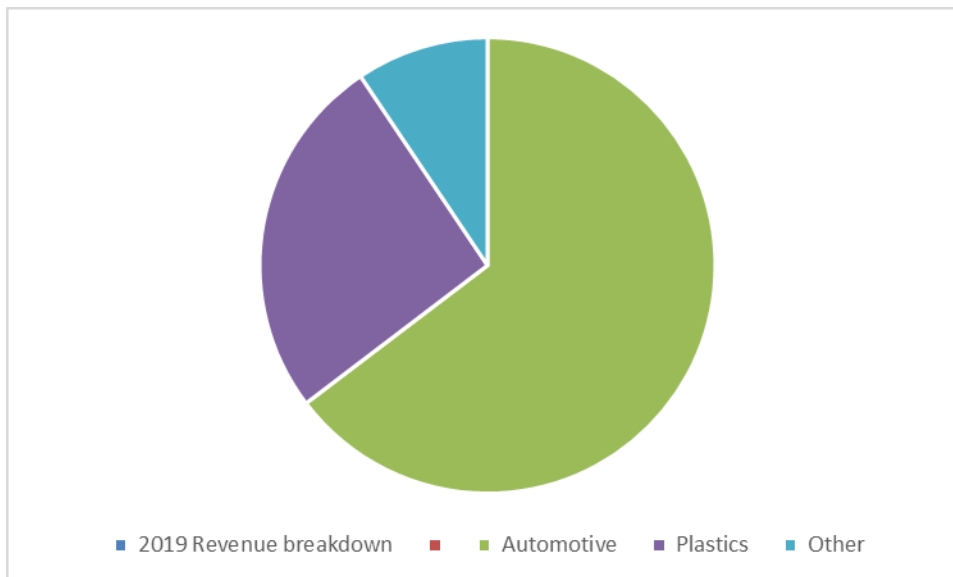
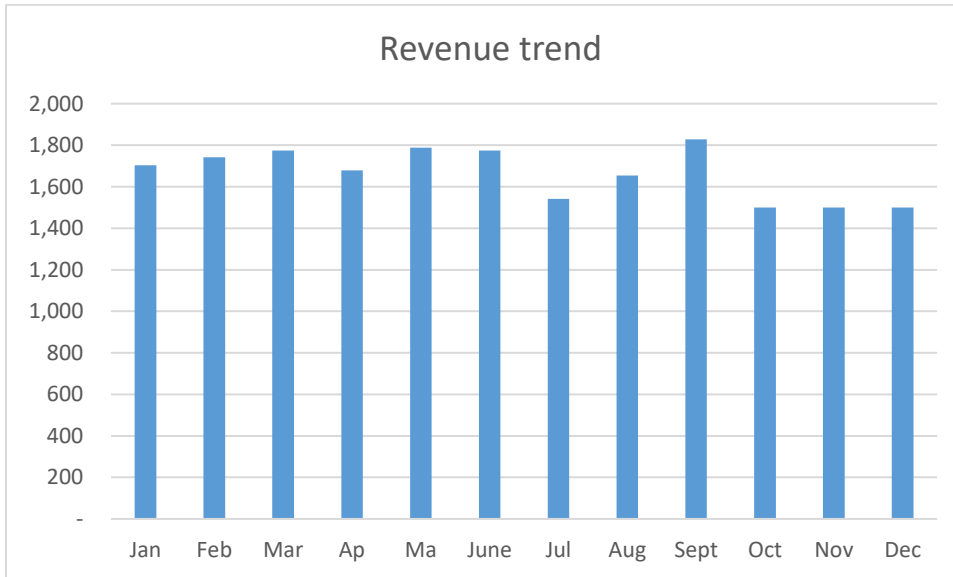
Note 1 -Common shares		
	#	\$
Opening	457,422	314,125
Issued	5,000	50,000
Redeemed	<u>(1,000)</u>	<u>(10,000)</u>
Closing	<u>461,422</u>	<u>354,125</u>

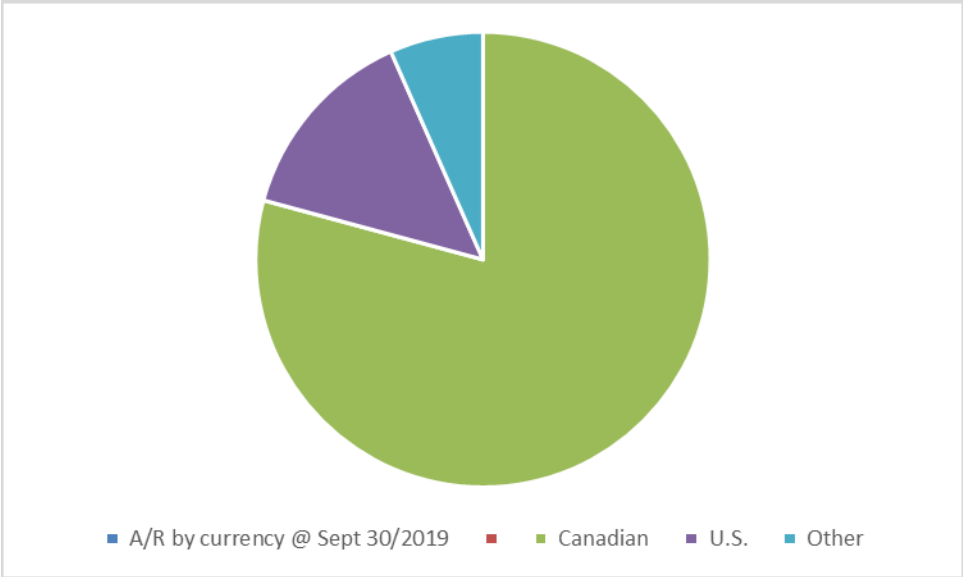
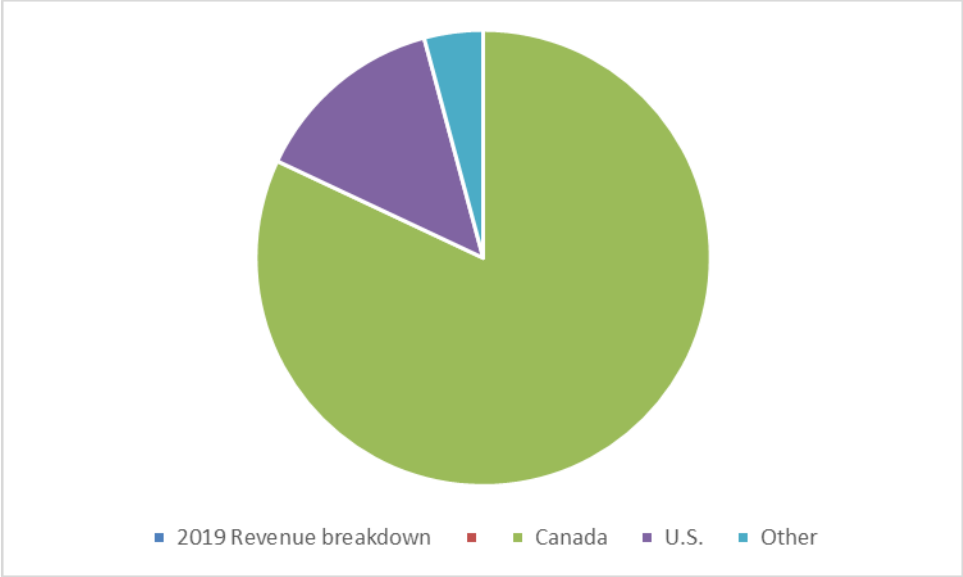
Additional financial information

	Accounts Receivable					TOTAL
	Sept 30, 2019					
	Current	1 - 30	31 - 60	61 - 90	> 90	
Artco		96,500				96,500
C200	241,022	106,000				347,022
Dock (1996) Inc.	19,544	8,512				28,056
Glenway Inc.		22,000				22,000
Hobo Corp	-	5,100			12,400	17,500
Kart Dev	66,792	5,645				72,437
Little Co.	5,978	12,840				18,818
Philips Limited		-			67,000	67,000
Regal Developments	42,000					42,000
Rio Properties		-			164,000	164,000
U.S. Northern	119,704					119,704
Wayly Plastics	241,525	1,740				243,265
Yellowmart	164,200	20,600				184,800
	900,766	278,937			243,400	#####

Major Project status report							
Project	Value	% compl.	A/R	Budget costs	Actual	Under/(over)	Notes
U.S. Northern	800,000	62.10%	119,704	347,020	346,203	817	No project issues
Yellowmart	910,000	44.0%	184,800	280,221	269,231	10,990	Ahead budget
Wayly Plastics	1,104,000	57.80%	243,265	480,033	640,033	- 160,000	Soil problems, high risk
C200	1,610,000	82.10%	347,022	925,012	940,121	- 15,109	Subcontracts low, BCI labour high

KEY HOLDBACKS @ Sept 30, 2019		
Customer	Amount	Expected release
Artco Inc.	96,500	Final inspection
Glenway Inc.	22,000	Nov-15
Regal Developments	42,000	Dec-31
Rio Properties	164,000	with lawyers
Other < \$50,000	169,458	various
	397,458	





Other possible changes or improvements

User needs

The financials should probably conform to GAAP, even though it is not required for private company interim financials. It might be required by the company's bank. Accounting Standards for Private Enterprises (ASPE or Part II of the CPA Handbook) will apply.

You should sit down with the VP, Construction and explain how the job reports provided to him from the accounting system relate to the monthly reports. A specific reconciliation probably should be provided. His monthly reports may not be on a GAAP basis. He or she should also be prepared for the additional questions that may come from the Board or management, now that more detailed project information is provided.

Consideration should be given to have a meeting with each of the executives and the Board to see if they are satisfied with the financial information they are getting.

Board members should be asking if the company has met its statutory remitting requirements, because they are on the hook for them. Therefore, it is a good idea to report the status monthly.

The new board member needs a 1-2 page financial briefing, the key financial issues related to the company, especially the important topic of revenue recognition. Alternately, there could be an orientation meeting with them.

Big picture

It would be good to discuss the tie-ins between the results and the company's overall business strategy. The company's competitors could be discussed, in relation to results.

A discussion of the macro-economy and the company's key customer sectors would be useful, if it is tied to the impact on the company. Sometimes the financing behind the customers is a critical issue.

New developments in the business environment the company faces, as well as any relevant new legislation or income tax, or tariff changes should be covered.

Input should be obtained from other executives, perhaps they should author a short section on their area.

Risks

A summary of the major risks faced by the company could be provided. It should also explain what management is doing about the risks. These risks include:

- Currency
- Technical
- Market segment concentration
- Competitive
- Credit and other

-
- Petroleum price (trucking and plastics industries heavily affected by it)

There could be a discussion of major upsides and downsides.

Reports

September 2018 comparative monthly and YTD income statement information would be more useful because of seasonality and is provided in the improved sample. In fact, more companies are reporting rolling 12 month results with rolling 12 month comparatives as the best way to see overall trends in the business. This is an excellent tip.

Reporting pre-tax income as a % of revenues, gives the executive a better sense of profitability relative to industry. The margin % is critical in the business and should also be included. Just because they are not included in the annual audited statements, doesn't mean they shouldn't be in the monthly statements.

Many users would like to see Earnings Before Interest Taxes Depreciation & Amortization (EBITDA).

Disclosure of the company's approximate monthly break-even revenue would be relevant to users. This could even be broken down into weekly or daily break-even.

A financial executive should try to think of useful ratios that will help management in analyzing the business, i.e. the contract acquisition ratio. Statistical analysis may be useful, for example the variance of a series of numbers or the standard deviation, compared over time can be quite informative.

If the balance sheet at the previous September 30, rather than the previous month was included, it would be more useful comparative information, because of the seasonality of the business. In fact, including several historic balance sheets would be more useful for comparison and trend analysis purposes.

Showing quarterly numbers and comparatives would be useful information, like a public company.

Prior period and year to date comparatives of revenue by industry selling to and geographic location would be more useful if provided. A prior year monthly trend would also be a useful comparison. Even better for management purposes, would be formal P&L segmentation by industry selling to and geography. Then management might realize for example that they are making the most money in say the trucking industry, which is a risk. Note that segmented reporting is not required under ASPE (it is only for public companies under Part 1 of the CPA Handbook and only if certain criteria are met) and may require a lot of systems changes. This could be taken even further through segmentation by type of construction if there are differences.

Direct costs should be broken out in to its parts. Likewise, sub-contracts should probably be broken out into different components, like design, mechanical, construction, etc.

It is not clear what the corporate overhead is, this could be broken out.

The expense captions are not that useful. Rent would normally be included in General Administration. Miscellaneous expense is much too large a % of total expenses. The major components should be broken out.

The report would not lose anything if all numbers were in thousands. (Make sure the reports still balance!).

Financial statement note on share activity might not be mandatory, but provides useful information to report readers.

Consideration could also be given to including full individual project status reports for very large jobs, that are already provided to the VP, Construction.

One topic in any internal financial reporting, is how much subsequent info should be disclosed in the narrative, considering the management implications, not the GAAP rules. If it is very material, it should definitely be disclosed, rather than waiting for the following month.

For monthly financials, the format is flexible. We know of a company that reports net working capital first on the balance sheet (current assets minus current liabilities). This is useful information for users.

Process

A detailed review of revenue recognition through percentage completion should be conducted since this an area which is prone to error due to the potential complexity.

Monthly financial statement review procedures should be put in place to find out exactly why the amortization errors took place and to ensure that they doesn't happen again.

It took the Accounting Manager 23 total days to report the month end results, that is about 15 working days. Steps should be taken to analyze closing procedures and improve the turnaround.

Bank and cash

The company's position relative to its bank covenants should be presented. This is not GAAP, but is useful information to the users. The calculation can be built into the financial reporting spreadsheet. The unused amount of the operating line of credit could also be presented.

No future-oriented cashflow information has been provided. Since "cash is king", this is very important for executives.

Receivables

It would be possible to report the trade A/R ex holdbacks, since this distorts the picture and to disclose the actual allowance for doubtful accounts.

Information on receivables and holdbacks could be segregated between complete and incomplete projects.

The old Hobo Corp receivable should be discussed, it sticks out as very overdue, although not that large.

There appears to be a difference between the A/R subledger and the G/L. The subledger is \$23,133 higher. This should be investigated.

Work in process and other receivables are very different assets and should be separate in the balance sheet.

The company could actually report **a roll forward of receivables**, which at least accountants would get a lot out of, for example (not actual numbers):

Opening inventory	\$ 14,322,323
Purchases and production costs	21,313,434
Write downs	- 430,000
Cost of sales	<u>1,604,829</u>
Closing inventory	<u>\$36,810,586</u>
Opening A/R	\$ 1,452,904
Sales	1,397,389
Collections	- 1,033,044
Write-offs	- 21,500
Change in allowance	- 43,000
Closing A/R	<u>\$ 1,752,749</u>

GAAP issues

A cashflow statement has not been presented. This is required under ASPE, and moreover is useful to users, reconciling opening and closing cash. A statement of retained earnings has also not been presented.

The company has taken a non-refundable deposit into income. This is not consistent with % completion accounting – the stated accounting policy. Although there might be an economic argument that they are fully earned, ASPE probably requires that they be deferred and recognized over the period that the fees are earned. I will be investigating if this has happened in the past and will report back to you.

Under ASPE, the taxes payable method may be used with no owner consent, it seems that this is the method that has been used. However, with significant temporary differences potentially arising from construction holdbacks, not using the future income tax method, might distort the financials.

The Wayly contract which is over budget should be checked to see if the loss for the entire contract should be booked, as required by ASPE.

It is possible that stock-based compensation accounting, ASPE Section 3870 must be applied because of shares sold to employees, depending on how the arrangement works.

The accounting for the share redemptions should be verified. It is only correct if the departing employee paid \$10 each for the shares, because there has been no change in retained earnings related to a premium.

Budgeting

The Budget versus actual variances in the current monthly financials are positive when sales exceed budget, but also positive when expenses are above budget. This should probably be changed to the normal way of presenting, i.e. expenses above budget result in a negative variance, because they are bad news. The caption should state favourable/(unfavourable). Some people use waterfall graphs to present budget versus actual.

Budget amounts for both month and year to date should be presented.

The Budget variation for direct project costs does not have much meaning, because most of the variation is due to the variation in sales. It might be more meaningful for the budget amount to be a % rather than fixed, so that this is a flexible budget.

The Budget probably needs revision, because of the huge C200 contract that was not anticipated in the Budget. Otherwise the budget versus actual deltas will be large.

The Budget appears to be a flat monthly amount, this is likely not appropriate given the seasonality of the business, a more accurate budgeting process should be used.

Interest expense in the month is quite a bit under the budget, this needs to be explained.

Future-oriented balance sheet information could also be provided.

What should be done about the September error?

The error is material relative to monthly income before taxes, but is arguably not material relative to 1% of monthly revenues. If the error was not amortization, it might be appropriate to inform the Board and executive immediately about it. However, since it is not that material and is non-cash (and won't put bank covenants off side), it can probably be dealt with in the October report rather than through restatement of the August and September financials. Suitable wording for this may be devised, without making the Accounting Manager feel bad.

Alternatives include:

1. Included in the month is a catch-up for amortization, not recorded in the prior two months.
2. No disclosure, just fix in the month.

If comparative monthly financials are presented, October should probably be adjusted, in the spirit of Section 1506 of the CPA Handbook.

Industry comparatives

Possible sources for industry comparatives:

- Google searches
- Benchmarking studies (may have to pay), some accounting firms have them

-
- Public companies (www.sedar.com and www.sec.gov/edgar.shtml sites are useful)
 - Industry trade associations
 - Available government statistics (Statistics Canada, Industry Canada, Department of Finance, provincial governments)
 - Exchange data with similar but not competing private companies
 - Dun & Bradstreet (know your NAICS code, formerly SIC)
 - www.fintel.us Financial Intelligence for Business
 - Gartner Group or Forrester Research
 - www.hoovers.com
 - nielsen.com may have some info
 - Your bank
 - Companies who approach you to offer themselves for sale
 - Private sellers of industry benchmarking information

www.Firstresearch.com
www.Researchandmarkets.com
www.anythingresearch.com
www.profitcents.com

Other

By selling the shares at \$10 per share, effectively a valuation of the company has been determined. How was it arrived at?

Other business measures

The top ones:

1. Average over/under on financial budget on jobs (most important)
2. Project backlog (aged is even more useful)
3. Project backlog (broken down by age, industry, geography)
4. Jobs being bid on, weighted, the pipeline
5. Pipeline conversion ratio (even by sales rep')
6. Lost bids
7. Average over/under on completion date on jobs
8. Average bid price miss (if known)
9. Business capacity use
10. Billings
11. Billings as a % of revenue
12. Book to bill ratio (contract signings/revenue recognized)

Others:

13. Contract signings in the month
14. Person hours worked
15. Revenue per employee

-
16. Gross profit/payroll (labour efficiency)
 17. Overtime hours worked
 18. Contract bookings
 19. Worker hours on projects
 20. Employees, opening, adds, departures, closing
 21. Employee turnover
 22. Employee morale
 23. On the job injuries
 24. Lost time due to injuries
 25. # jobs in progress
 26. Capital expenditure information
 27. Project risks & upsides
 28. Warranty claims (contractual)
 29. Warranty claims (goodwill)
 30. Key subcontractor info
 31. Idle assets
 32. Customer satisfaction/work quality
 33. Days sales outstanding
 34. Market share
 35. Website statistics
 36. Average project size
 37. Debt service ratio

There is an important question as to whether finance should validate the non-financial information. The answer is probably no, but if anything is obviously, wrong or inconsistent, it should be questioned.

In addition, consideration could be given to reporting relevant ratios such as return on sales, return on equity, return on assets, etc. if they would be useful to the company. Some company's like to use some of the new ratios, such as the Dupont ratios (<https://courses.lumenlearning.com/boundless-finance/chapter/the-dupont-equation-roe-roa-and-growth/#:~:text=The%20DuPont%20Equation%3A%20In%20the,turnover%20multiplied%20by%20financial%20leverage.>) If you start presenting these, they should be fully explained, and probably should be done monthly, they should be done for a full fiscal year, or rolling 12 months, a month is too short a period.

Although not common for a private company or required, calculating earnings per share is useful and helps shareholders see what their "piece of the profits is". Other variations could include for example executive compensation per share.

It could also be noted that the company may have room, based on the balance sheet and the equity amount, for some additional long-term debt.

It is not clear if the company has its US business in a US legal entity. If yes, there are consolidated financials, and should be labelled as such.

The project summary could classify the projects as green light, red light, or yellow, based on good, bad, or possibly problematic.



BANKING OFFER CASE SUGGESTED APPROACH

Note:

This is a suggested approach, not a “correct” approach and it does not necessarily represent the only way the case could be handled. Negotiation options here may be able to be used for all kinds of bank negotiations, that may be different from this scenario.

General

The offer from the Northern Bank is not a bad one, but a number of questions need to be asked and it may be possible to improve on it. The Bank was reasonable enough not to demand very extensive budget or business plan information before the loan was granted, in this small business context. So far, the company has not been able to generate an offer from more than one bank, so it is not in a position to leverage other offers. If it had very good financial reporting and a strong business plan, it is likely that more offers could have been received. Perhaps it would be better to get a **longer term for the agreement**, but this is a new client for the bank.

In negotiating with the Bank, the founders should consider moving their personal investments/RRSPs to the Bank, offering a group RRSP with the Bank, and using the Bank’s payroll service (if they have one) and other ways to give the Bank more business and possibly obtain negotiating leverage. If the company can perform well with the Bank for one year, it will have more leverage next year for the renewal.

Legal advice, from a good lawyer, with lots of banking experience should be sought before getting back to the bank.

If you can network with other small business people who have a Northern Bank operating facility, you might get a better idea which of the clauses in this agreement are standard Northern Bank clauses and which ones represent the Bank being a bit hard on your business. What the Bank does see is growth and they would like to get you signed up now, so they can be your banker if you really grow to become a major client. Being a newer Schedule B bank, they may be a little more hungry and less risk adverse than the large Schedule A banks. It would be good of the Bank has experience in this industry.

The company probably needs a little more time than 14 days to consider the offer.

With proper financial projections, the company might get a better deal.

Account manager

Your account manager, Herbert Shylock seems generally supportive of your business. The credit people are actually more important and it is hard to meet them. You may be able to ask for a new account manager if you ever find the relationship not working.

Size of facility

You asked for a \$300,000 operating facility and a \$150,000 term loan and the Bank has fallen short in their offer.

The company has been growing at over 200% per year to date. You have to question whether \$250,000 is a large enough operating facility before too long and with the forecast for 2020 sales of \$8 million. Some banks use a 10% of revenues rule of thumb for operating lines of credit. The problem is the Bank will probably not offer any more to a young, relatively unproven company. One argument to use with the bank is that if receivables are say \$1M, their operating facility is extremely well-margined.

Have any non-bank operating facility providers been considered? Have suppliers been considered as a source of financing? Has warehouse equipment vendor financing been considered? Has leasing been considered? Have any asset-based lenders been approached? Have any government supported lenders been approached? (Note that company would not qualify for a federal-government backed Small Business Loan covering capital expenditures up to \$250K, because revenues exceed \$5 million. However, it could set up additional related companies with revenues under \$5 million, in order to qualify.) Could the company considering factoring receivables (selling them), to provide cash and reduce the need for an operating facility?

Note that there would be security interest issues versus the bank's General Security Agreement if another lender had a security interest.

Personal guarantees

The personal guarantees required of the founders, including a security interest in their principle residences, are likely very objectionable. The bank wants them to reduce risk, and ensure the business owners have some "skin in the game".

The personal guarantees also require the involvement of their spouses and the complication and cost of independent legal advice.

Arguments against the personal guarantees must be developed. However, the owners were on the hook for cash previously, so they may not be overly worried. Arguments included:

- Reducing the facility size and eliminating the personal guarantees, this finds out their value
- If inventory could be margined instead of A/R, they should be dropped entirely
- A limited personal guarantee of say \$100,000 each
- A limitation against the principal residence
- Provide some other collateral, say some personal investments, and exclude the principal residence
- A limitation against property owned jointly with the spouse
- Reduced guarantees in return for a family compensation cap

-
- Keep more shareholders loans in the business, would the bank agree to reduce or eliminate in this case
 - The Bank agreeing to drop the guarantee after a year
 - The Bank agreeing to consider dropping the guarantee after a year
 - A sliding scale down guarantee
 - The Bank agreeing to drop the guarantee once the company has a certain level of equity in the business, for example \$900,000
 - Covenant trade-off with the bank versus personal guarantee change

Finally, the founders could ask the bank, what they would like in order to remove the personal guarantees.

Interest rates

It is best to finance long-term assets with long-term financing at fixed rates. The term loan has a floating rate. This adds risk to the financing. (It is absolutely standard for Operating Facilities to be floating rate). You could ask the Bank about this, but they may not be interested in changing, or they might give you a rather high fixed rate. The economic trade off between a fixed and floating rate depends on one's views of interest rates and risk. You might be able to lay off the risk by entering into a fixed for floating interest rate swap, although the amount may be a bit small for the market. Some might argue that the term loan should have a lower rate than the operating facility. It would be preferable to have the choice of fixed or floating.

A longer loan term should be preferred, perhaps approaching the useful life of the equipment.

The term loan payment including principal will actually decline over time, they are not a traditional flat payment schedule like most mortgages, this is not that favourable.

For comparison purposes, this is a newer bank, you need to find out if the bank's prime rate, Canadian and U.S., generally moves with the Schedule A banks' prime rate. Some historic data should be available from the account manager.

Prime plus 2.5% seems reasonable for a young business, given the risk. You should ask them to consider reducing the rate after a year. They won't promise to do this of course. Another alternative is a lower rate on the say the first \$150,000 and a higher rate for the balance of the loans.

You could argue that the rate on U.S. loans should be the same as Canadian, after all the risk is the same.

You might be able to negotiate a rate improvement if for example the net worth or current ratio increases to a specified level.

Perhaps the bank would go with an interest and or principal holiday on the term loan, but there would be trade off for this.

The interest rate on late amounts is a rather punitive prime plus 9%, this should be argued with.

The interest rate for funds on deposit is a measly .3%. This should be negotiated higher. It would be easier to negotiate this with some comparable numbers.

Operation of facility

The facility would be slightly cheaper if the revolving was in multiples of \$5,000, \$1,000 or even nothing, rather than \$10,000.

Fees and costs

In summary, you need to ask the Northern Bank to sharpen their pencils and reduce their fees. They are hitting you with fees all over the place. There is an up front fee, as well as a monitoring fee, a renewal fee and the current activity fees. You are not renewing, you are setting up for the first time. Perhaps they could make it one fee so it is less confusing. An estimate of the direct revenue to the Bank under their proposal is found in Table A and it is over \$30,000 per year.

The Bank wants to have the right to increase its activity fees at any time. This is not acceptable. They should at least hold them for the term of the agreement. Alternately, they should only move when the bank moves them for all its customers. Consider obtaining a bank fee survey that is publicly available for comparison purposes. (and Canadian example can be found at <http://www.bankservicefees.com/>), but it is getting a bit out of date.

Your company will have to bear the legal costs. Taking security interests costs money. You don't want these to be too high. You should ask the Bank what the estimated legal fees including out of pocket costs are and which law firm they propose to use, or are they using in house Bank lawyers. If the proposed law firm is an expensive, consider trying to get the Bank to use a cheaper one. Have the Bank ask for quote from the law firm that they pass to you before starting. Try to get the fees capped. This might help keep the fees at least partly under control. Finally, in some cases, we have heard of banks using the client's lawyer.

Margining

The Bank does not appear willing to margin any of the company's inventory. It is common for inventory to be marginable in a bank agreement. However, if the Bank is only willing to provide a \$250,000 operating facility, the receivables alone may support it.

Since the company sometimes sells to Spain and Portugal, the exclusion of these countries may cause a problem. This should be discussed with the Bank. It is possible that security interest laws in these countries mean that the Bank excludes them. Could the bank margin them at say 25-50%? It may be necessary to get EDC (Export Development Corporation) credit insurance, which is generally in the 40 to 60 basis points range for approved companies. Credit insurance is also available from some private sources. A broker can help select the best source.

Excluding receivables 90 days after invoicing, when some customers may be strong and are on 60 day terms does not make sense. When 31 days late, these receivable are not marginable, whereas a net 10

receivable is marginable when 79 days late. However, if this is a standard policy the Bank may be unwilling to change.

The “any portion of which is outstanding more than 90 days from the billing date” definition of Good Accounts Receivable means that if \$1,000 is disputed with a good account, nothing is marginable. This is not favourable, but is a typical bank approach. It might be possible to persuade the Account Manager to margin receivables with these issues. Another solution, is get the bank to agree to go by specific invoice.

A compromise might be that if less than 10% of the total receivable from a customer is overdue, then the balance is still marginable.

The company should also have the ability to persuade that a particular receivable is good, even if it not good by any of the fixed criteria, i.e. it is proven good because the customer paid after month end. The bank may be willing to have some “named” companies who are “blue chip”, who they will margin, even though by the agreement, they could not be margined.

The source deductions portion of the statutory prior claims will have no impact since you use a payroll service which makes all the required remittances.

Financial and bank reporting

The Bank is several years out of date, deferred taxes no longer exist under Canadian Generally Accepted Accounting Principles. You should get the Bank to change this to future income taxes, for greater clarity. Unless the company has larger future income debits than credits, this will help the current ratio covenant.

The Bank may be asking for financials too soon after year end, at 60 days. You are still getting consistent reporting in place. The auditors will be busy with their bigger clients in January. You should talk to the Bank about this and ask for 90 days. If this fails, you will just have to work hard and book the auditors for mid-February.

The Bank has asked for audited financials, perhaps because the company is a new client. A first audit will likely be messy and costly. Often in small business, the Bank will accept a Review Engagement only. The company has never had an audit before. The cost will be very roughly twice the price of a Review Engagement in terms of my time and professional fees. However, the shareholders will get greater assurance on the financials. Consider asking the Bank to drop the requirement to a review instead, or at least make the change after the first year, if all goes well. Another compromise position is to have the accountants do a review and a report on performance of “specified procedures” on accounts receivable (and inventory at necessary). This would likely be cheaper than even a review, but would have to be approved by the Bank. Another possibility is only specified procedures, but it would not give the Bank any assurance on the financials as a whole, so they would be unlikely to agree. The ideal would be acceptance of management’s statements, or just a Notice to Reader.

It would be simpler if all Bank documents were due 30 days after month end, including the financials, which the company has some difficulty in producing on timely basis at this point in time.

Budget

The Bank requires an annual budget including balance sheets, income statements and cashflows. It will be good discipline to prepare a budget. This should be useful to the company otherwise and hopefully not too onerous once good reporting is in place. Note that the new interest expense will need to be budgeted in it.

Covenants

It is important that the covenants be examined to see if they are reasonable and maintainable for RI. They need to be stress-tested. If they are not, RI could find itself needing to repay the Operating Facility and/or the three year term loan on demand, without the funds to do so and facing a real crisis. From a general banking perspective, they are not unreasonable. A 1.75 to 1 current ratio would be more common than 1.8, a rather odd number. Some banks will exclude their debt from the current ratio calculation.

A “covenant cure” clause would help protect RI. It could state that upon violation of any covenants, the company has 30 or 60 days to “cure” the violation, before the bank can take any action. These are found in some banking agreements.

You should ask your network if they know how “patient” the Northern Bank tends to be in this city, with clients who violate covenants. Do they “pull the plug” immediately, or do the work customers? This information would be helpful.

A ball park calculation of the company’s year end net worth is \$600,000 plus \$180,000 profit, less \$40,000 in dividends, giving approximate net worth of \$740,000, better than the covenant minimum but close. You should probably do a detailed projection of the year end balance sheet, before signing the banking agreement to be very certain you can comply. It is actually quite difficult to project the company’s current ratio other than to consider trend analysis.

The Bank wants to test the covenants monthly. If you could get them to move it the test to quarterly or even annually, this would be better for RI, particularly given the difficulty producing financials. The Bank will probably not agree to this.

The Bank’s net worth calculation, does not include, as “equity”, related party indebtedness that has been postponed or subordinated, to the Bank’s satisfaction. This would help the company’s position relative to the covenant and would only make sense, see discussion under veto rights, if there still was related party debt in the future. Shares that can be redeemed should be included in equity.

You may want to try to get the bank to flex the facility with the level of tangible net worth, so the facility is not shut down, if the company’s tangible net worth goes say \$50,000 below the covenant level.

Since you have some software licenses on the balance sheet, you may want to find out if they are considered intangibles by the Bank. They arguably don't have "physical substance", but they aren't mentioned in the offer letter. Since they are recorded under property, plant and equipment, this is less likely. One approach is not to ask, since they are not specifically excluded. The other approach is to get clarification now.

The founders have started some estate planning steps. Estate planning often includes the issue of high-low preferred shares (redeemable and retractable at a price that far exceeds the issue amount, to fix their value for income tax purposes). Under IFRS these must be booked as liabilities. This could cause some covenant problems. Under ASPE, Section 3856, it is possible they can be reported as shares, with the proper disclosure. You might want to discuss this with the Bank now. Exclusion from debt under the terms of the covenant definition would be reasonable. The Bank might insist on a retraction veto right.

The actual details of this Bank's version of a debt service covenant should be obtained and then some projections should be done to measure estimated future compliance. The covenant would likely involve dividing debt service obligations by income or cashflow before debt service obligations. Then the company can decide if it is less constraining than a current ratio covenant. A rolling test would be better, that includes several months or quarters, because it would smooth variations.

The issue of business seasonality must be considered in terms of projecting covenant compliance or even negotiating a looser covenant for the weak periods in the year.

Veto rights

The Bank proposes veto rights on dividends and repayments of shareholder loans, as well as changes in ownership. The latter could restrict estate planning flexibility.

Note that you can always take out shareholder remuneration in the form of salary or management fees, without the Bank having veto rights. However, this has different tax consequences and you would rather have complete flexibility.

You should argue that if the covenants, particularly net worth, are on side, the bank should not worry about restricting dividends. Another possible position is that you promise to give the bank notice of dividends. Consideration could be given having an arrangement such that the dividends could be paid if say an equal amount was repaid on the loan facility. Finally, a fall back position would that dividends more than \$X (historical average perhaps) need approval of the Bank, "such approval not be unreasonably withheld." This last clause would give the Bank some pause in vetoing dividends on a whim.

A compromise would be a total remuneration (all types) veto, with a lot of flexibility

The Bank shouldn't be able to refuse payments to shareholders and at the same time call them liabilities in the net worth calculations. This is a fundamental contradiction and you should insist the Bank must change either the veto clause or the covenant clause. Hopefully shareholder loans can all be repaid with the Bank money and they will be no more, so this is a non-issue.

It might be possible to actually convert some shareholder loans to equity, to help the net worth calculation.

Perhaps a cap on total remuneration would be another option.

Bank outs

The Bank has asked for a clause that it may cancel or restrict availability of any unutilized portion of this facility at any time and from time to time without notice or demand". It would be preferable to get a committed facility, but difficult, given the company is a new client, with no track record. Perhaps it could be negotiated as committed, with higher fees, unfortunately.

The "major undesirable developments in the sole opinion of the Bank" is a clause under which the Bank could call the term loan, almost on a whim. This is similar to the "material adverse change" clause that some Banks try to impose on customers. Essentially this means that if they don't like something, they can pull the plug on the Term Loan and demand payment and the company could not question the grounds for the judgement of major undesirable developments. If the economy got softer, the Bank credit people got nervous and the company had a weaker month, RI does not want to be in the position of facing bankruptcy because of this clause. Therefore, RI should argue vehemently against this clause, telling the Bank, they already have lots of "outs".

This is a one year agreement, but the term loan is longer. It needs to be clear that this won't effectively reduce the term of the loan.

If there is an event of default under the agreement, the facility must be repaid. There is no provision for getting out of default. This should be provided for, or it is not fair. For example, the company is in default for not having the life insurance. Based on the offer, they can't get out of default, by getting the life insurance.

The offer says that "the Borrower defaults in the payment of any indebtedness to any Person". This might mean a technical default on a minor obligation to a supplier might collapse the whole banking agreement. Perhaps a dollar limit should be provided, over \$40,000 for example.

It would be better to divide the types of breaches or events of default into major and minor, the latter not resulting in the loan being called, but

Other notes

Give the company has some foreign sales, the company should negotiate some foreign exchange facilities. If the company faces longer term foreign currency risks, it might want to enter into forward contracts to buy or sell currency, and these have banking implications.

As the Tans seek to get out of the business of personally financing the company, the shareholder credit card should probably be dropped. In this context, a credit card facility should be requested with the Northern Bank, that is company debt, rather than personal debt. The Bank might be able to help, by

carving an amount out of the credit facilities. If not, other credit card companies could be approached for a corporate card.

You will need to ensure that the founders get the life insurance because otherwise the facility could become null and void. Quotes should be obtained immediately to determine the cost so that it can be considered and budgeted. The cost should not be that high given the age of the founders, if they are in good health. We have heard life insurance that fluctuates with the changes in the total bank debt, so that the cost was lower.

You should ask the Northern Bank if they are set up to work with the Export Development Corporation, to help RI with possible future exporting needs, in addition to credit insurance.

You should ask that Bank what “such other financial and operating statements and reports as and when the Bank may reasonably require” might be, so that you are prepared. The Bank should be satisfied with the monthly and annual statements and the budgets.

The company must ensure that it has no environmental issues, because of the strong standard clauses the Bank agreement includes in this regards. This may require specialized professional advice.

The pay date of the term loan might be more convenient for accounting purposes on the first or last day of the month.

The monthly reports could be put in a spreadsheet, to facilitate the preparation thereof. Perhaps the Bank has such a spreadsheet.

It should be noted that some people find that wire transfers sent by Schedule B banks, are not as reliable as Schedule A banks.

Table A

Bank's total return

<u>Total bank fees</u>	
Set-up fee	2,000
Monitoring fee	3,600
Renewal fee	1,500
Activity fees	2,160
Interest	
P+2.5% times \$300K	15,600
	24,860
<u>Assumption:</u>	
Prime is 2.7%	

ETHICS SCENARIOS DISCUSSION NOTES

Note:

These are discussion notes, not a “correct” approach and they do not necessarily represent the only way the case could be handled or legal advice. Professional advice should be sought.

Scenario 1

- Consider rule 205 (Quebec, 34)
- The perfectly ethical solution is to ask the bank to clarify the rules in the situation where returns are expected
- Could sign and advise the bank in a footnote that: “accounting provisions for estimated future returns against these receivables are \$42,000 and this estimate may be low” or something to that effect
- Above two alternatives may not be accepted by President
- Also consider whether return provisions are sufficient for financial reporting

Scenario 2

- Ask President for justification
- Assumptions need to be clear
- See if the new investment will justify the cost reduction
- If not justified, this forecast may be misleading and could get you in trouble under rule 34
- If you noted that it is the President’s forecast, not yours, the disclaimer is irrelevant because you are associated with information and ought to know
- Consider FOFI rules
- Disclosure of past margins would certainly tell user that these future results are unlikely
- Consider what Handbook says in 4250: **forecast** (plan and probable economic conditions) versus **projection** (plan plus hypotheses, not necessary most probable)
- I find this doesn’t totally make sense because non-CPA users won’t know about 4250

Scenario 3

- Don’t worry, it has nothing to do with you? No, there are at least financial reporting implications of this
- Find out if the CEO/Board know about the bid rigging, if yes, a big problem, if no, and they will clean this up, you can work here
- Resign. You don’t want to be associated with a company that has such practices. You don’t want to be known in your career to be working for an unethical company
- Call the whistle blower line
- Send sales a copy of the article
- Must you report to government or police? Confidentiality probably over-rules (rule 208.1) (Quebec 48)

-
- Consider financial statement accrual/contingency implications, is the event triggering the booking, the fraud or must you wait for a charge by the government?

Scenario 4

- Management over-ride?
- Leaving it up the CFO is not the solution
- Call the CFO even though they are away
- False & misleading, rule 205 (Quebec 34)
- Asking the President to put the request in writing may help
- Greater risk since public
- The A/P subledger won't balance
- Defence – auditors will find entry and reverse, doesn't hold, you are still responsible
- Whether you can tell the auditors or not is a gray issue
- Talk to Board if independent, confidentiality not broken if you do, also the Audit Committee
- Don't resign. General rule, if you refuse you could be fired for insubordination, but they are unlikely to be able to argue that you were fired for cause, so you would likely get a termination package. You need to see an employer about this.
- They may be afraid to terminate you, because of what could get out if you sue

Scenario 5

- Some would say both parties agree, there is no cash impact, it is fine
- Can you just say it is immaterial? No
- This does not comply with PO terms
- A false and misleading invoice will be produced by the accounting system
- Accounts payable and approvers of bill at customer need to be able to trust the description on your invoices
- You may be helping the customer's project manager deceive his/her superior
- What about the next time when they ask for a bigger invoice change?
- Need better management of cost over-runs as a business practice, and don't be lazy, re-issue the paperwork
- Need to do a better job next time of predicting costs
- Need better communications with sales
- Issue may be uncovered by a supplier audit
- This could result in problems for the company's inventory accounting and possibly revenue recognition
- There could be bonus calculation implications

Scenario 6

- A not uncommon, but difficult situation
- Consult shareholders' agreement
- Consider employer confidentiality and professional confidentiality
- Consult a lawyer
- Practically speaking, if you don't comply with the request and she wins the dispute, you may be out of a job
- You need to ask what she wants you to do specifically when on her side, so you can assess the situation
- You should probably stick to what your written job description requires you to do
- The shareholder is not part of management and has no right to the information, unless approved by the Board
- If you can get all the parties to agree on the information disclosure, before providing it, you couldn't get in trouble

Scenario 7

- Very common owner-managed business situation
- Does the owner use the cottage for business?
- Re salary, it is possible that the spouse does work at other locations
- For income tax, small spousal salary with a small amount of work is OK
- Clerks can't stand up to senior executives easily, you need to help them stand up against pressures. They also might not know if something is wrong
- If not a real business expense, financials are false if booked as an expense, should be booked to shareholder loan
- Owner may say they can do what they want with their money, which is true, as long as it is reported properly in the financials and tax return
- If T4 the owner for the benefit, it is OK, but should be reclassified to compensation
- Could tell owner that this will hurt, if the company is ever put up for sale, expenses look higher
- Tax fraud if booked as an expense
- Rips off outside shareholders if there are any
- Consider rule 205 (Quebec 34)
- Talk to the owner about it
- Makes signing off the tax return difficult
- May need to book the salary as advance to owner

Scenario 8

- Final decision is not the same as analysis
- There may be qualitative swing factors
- Just play dumb and complete your analysis honestly and let the chips fall?
- Complete the analysis by noting items such as "I doubled this number without justification, because I was told supplier A must come out on top"
- Refuse to do any analysis?

-
- False & misleading issues
 - Call the whistleblower line

Scenario 9

- Weak internal processes: President should not write cheque to self
- Check if the President's comp package has changed, since you last saw it
- Potentially taxable benefit T4 issues and you be signing the T4 summary
- You don't want to assist the President in violating policy
- You have an implied responsibility to shareholders
- You should discuss the issue with the President
- You may have to discuss the issue with the Board
- You may need to refer to your written responsibilities as a cheque signer
- You could just play dumb and go talk to the CEO or the Chairman of the Board about a possible error by their assistant
- You could do it and book the charge to Loan to President
- Real-life solution: The Treasurer put together some medical expenses outside company policy and put in a claim for them to the President. The President came charging into the room and said "what do you mean by claiming this?" and the Treasurer took out the President's claim and said "what about yours?" The President realized she was a hypocrite and withdrew her claim!
- If I was doing a fake like this, to protect myself, I would send an email to another colleague beforehand, saying my expense claim is not real, it is a test...

Last class scenario

- In basically all the scenarios so far, you are under pressure from others. Here is a personal temptation situation, that doesn't involve any one else
- Obviously you cannot even contemplate doing it
- Clearly, there is a control weakness
- You need to put some controls in place so your successor can't be in a position to do this

Bonus scenarios, not planned for class discussion

Bonus scenario 1

- Are you bound to work there for life?
- Verify terms of employment to see if the situation is covered
- Consider your personal integrity
- Get your new employer to pay all or some
- You could pay them back, all or some

Bonus scenario 2

- Not a professional standards issue per se, if the other executive is not a professional accountant like you
- Consider team work implications
- Interpersonal skills will be important in resolving

Bonus scenario 3

- Very common situation
- There are accounting implications of withholding
- Results in false and misleading issues re statutory remittances and signing the T-4 summary

Bonus scenario 4

- Key: does the shipping charge purport to cover the Fedex bill, or shipping and handling, or does it not say
- If only supposed to cover Fedex bill, associated with false and misleading, rule 205 (Quebec 34)
- If shipping and handling, no problem
- Note: not for profits can make money on publication sales

Bonus scenario 5

- The issue is documentation and approval and the raise doesn't seem to have been approved
- Consider telling the Board
- May need to book as loan, rather than salary
- Do you want to work for this leader?

Bonus Scenario 6

- The real question is whether the position is just quite aggressive or is it unsupportable/completely offside?
- You could ask CRA for a ruling, but this will take time
- There will be a tax provision reporting issue
- Consider talking to the CEO (be very careful before going above your boss)
- The position is clear on the tax return, it is not hidden
- You are normally responsible for taxation, so the position reflects on you, even if you don't sign

Bonus Scenario 7

- Confirm that the position was in fact wrong, perhaps check with the auditors
- Correct it and inform stakeholders, may need to discuss with the Board
- Should you call your professional body and report yourself to them? Rule 211 says you must report other CPAs
- If at some point you get reported to your CPA body, you will be in a lot better position

Bonus Scenario 8

- Ask what the terms are
- Make sure it is recorded correctly in the financials
- Consider other stakeholders, such as the bank

Bonus Scenario 9

- Consider minority interest perspective
- Check the shareholders' agreement to see if it cover this type of things
- Ask why the money was advanced
- Ask the CEO if the Board has approved the advance?
- Find out if there is interest on the advance
- Make sure it is recorded correctly in the financials as a related party balance

Bonus scenario 10

- “cookie jar” accounting which is common, but not right
- The essence of what was done at Nortel did in its last years, as I understand it, there were charges, **but** the accountants were acquitted
- Management override issues
- You should consider whether you should report the other CPA under rule 211

FOREIGN EXCHANGE CASE SUGGESTED APPROACH

Note:

This is a suggested approach, not a “correct” approach and it does not necessarily represent the only way the case could be handled.

General

Analysis of situation

You need to first analyze the foreign exchange risks that the company faces

1. What currency risks is the organization exposed to?
2. What volumes of foreign currency risks are anticipated?
 - Which currencies? (USD, Mexican, maybe)
 - What is the net exposure to each currency?
 - What percentage of sales does each currency represent?
3. When are they expected to occur?
 - Has cashflow forecasting been completed? How reliable are the cashflow forecasts?

The company needs to perform a sensitivity analysis, i.e. what does a 1% change in the currency rate do to the bottom line? This will be difficult to do without budgets. It may be possible to do it roughly with the old Business Plan.

Currency risk philosophy

Having identified the risks, the company must determine its philosophy with respect to foreign currency risk.

The company’s core competence and business is making money, developing and selling networking gear, **not** speculating on exchange markets. Speculating on exchange markets is highly risky and specialized. Even the top professionals and economists in the field have a lot of difficulty consistently predicting future exchange rates.

If a company does no hedging, then it is either saying:

- We don’t care about exchange risk; or
- We believe that exchange movements will be in our favour

Neither of these is a good approach. This is sort of what the company’s current ad hoc hedging strategy, based on what the Accounting Manager and the President “feel”, is. Currently the accounting manager is occasionally, but not systematically taking a view on currency moves along with the founder. The inherent risks must be explained to these individuals. The explanation to the founder

will be quite sensitive. A calculation of the potential loss based on say a two cent swing in the currency could be shown to make this more concrete.

(Some would disagree with this analysis and say that companies should take a view and then hedge accordingly.)

The overall decision on the philosophy should probably be taken to the Board for a decision.

Without becoming bureaucratic, the company may want to develop a foreign exchange risk management policy. The policy could cover speculation (not permitted), hedging approach and could even cover back office controls. Some sample points to be included are in the course slides.

Exposures

The exposures identified are:

- U.S. currency sales revenue, amount unclear
- U.S. currency purchases, about 40%
- Some Mexican peso expenses related to sales rep' activity (likely small)

There are indirect exchange risks that it is hard to do anything about. For example, if your customers are in the U.S. and they are hurt by a weak U.S. dollar as they are importers, then they might not buy as much from you, which hurts your business because of indirect exchange movements.

Moving forward

Assuming the Board approves a hedging philosophy which seeks to reduce or eliminate all exchange risks, RGC should proceed to hedge its current receivables and payables with forward contracts. It is probably not worth it for small amounts, say under \$5,000. It is also not worth it for the Halls Gear A/R and the Future Electronics A/P, because there is a natural hedge between payables and receivables of almost the same amounts and the same date.

Because the company's customers usually pay on time, it will be easier to use forwards. If the company does not pay on time, the company is still better off than if it was not hedged at all.

The company could enter into forward agreement with a window to sell currency, rather than a specific date, for example, a forward to buy U.S. currency during the month of January 2020, for \$44,785, since payment of the Fabview Shop payable is being delayed. The rate for these forwards may be slightly less favourable than a regular forward contract. This is also called an option-dated forward.

The accounting manager should not be upset about the hedged currency purchase. The objective was to obtain that hedged rate and it was obtained, therefore the hedge was 100% successful. What really happened with the market rates does not matter.

There can be compromises in terms of hedging, for example, half of known estimated exposures, but this leaves unprotected risks.

In addition, the forward that is meant to cover the Jan 11 receipt from Tofino Corp, matures January 10, actually a day early, perhaps due to customer slippage.

The company should not sell to Canadian customers in U.S. dollars to reduce its exchange risks. In fact, there may be hidden distortions to this type of selling if the Canadian customer is hedging their purchase risk, although Rocky Gear may not know about this. In some cases, the customer may be trying to create its own natural hedges.

Other currency risks

In due course, if the company is successful in obtaining sales in Mexico, peso currency risk on sales may be experienced. However, it may be more likely the company will transact in U.S. dollars, which would be a more liquid market. There must be some peso risk relative to the sales person's regular expenses, but it can't be very material.

Spot transactions

The Accounting Manager's approach to converting US currency at spot is speculation to a certain extent. Balances should be converted immediately. The rate could just as well move against the company.

The company needs to start getting better spot rate conversions. Doing an exchange at the branch level usually results in a poor rate. Many dealers and bankers will call if a particular rate is hit. The company may even be able to place standing orders if a particular rate is hit. The current market rates can be monitored via the Internet. (This is a little bit speculative.)

Alternatives include:

- Asking the company's bank for a way to get a better rate
- If the bank has one, using its on-line exchange facility
- For larger transactions, going through the bank's foreign exchange trading desk in the major cities
- Better still, make the bank bid competitively against the trading desks of some other major banks
- Using one of the many independent exchange houses, see list at the end of the material
- Using a combination of the above and always taking the best rate quoted
- Exchange the currency with a customer or other third party organization at an advantageous rate to be mutually agreed upon

Note: It may be useful to set up a spreadsheet that compares amount, rates quoted and transaction cost differences, if any, to pick a bid winner. For example if a third party bank wins the bid, it may be necessary to wire the money at a cost. (see example, Appendix I)

The company should get a US dollar bank account.

Banking issues

Forwards give the bank risk and will normally tie up a portion of the company's bank line. Most banks use a formula that considers the volatility of the currency and the time frame. The amounts are more in the 4-15% range, and RGC does have fairly limited bank credit. Export Development Canada can assist with margin requirements, for companies that export.

If a company doesn't have a bank line, cash margin deposits may be required, based on a risk formula.

Consideration should be given to trying to improve the company's banking facility so it meets the company's needs. The company may even need to switch banks. During the beauty contest, if several banks are considered, key foreign exchange, as well as other critical banking questions should be asked.

Practically speaking, bank credit risk is not a big issue. The large banks in Canada are stable and relatively strong. If one enters a bunch of forward contracts, chances are some will go up in value and some will go down in value. The entire principal amount is not at risk, just the "in the money" parts. The risk at any point in time can be determined through a mark-to-market calculation, see Appendix II.

Bid risk

The company has foreign exchange risks that it may not have realized. Once a price has been quoted to a customer in a foreign currency, the company has bid risk, until the customer accepts or rejects the bid. There are a number of ways to go about dealing with bid risk.

Bidding in Canadian dollars, or having an adjustment clause if there are currency movements, would likely be rejected by the customer. Including a large exchange cushion in the bid, could mean the bid will be lost.

The problem with bid risk is that the company is not certain whether it will win the bid. As a result, forward contracts would not be the appropriate way to deal with the situation. If too big an exchange risk cushion is built into the bid, it might be lost. Therefore, one way to deal with this is to enter into a contract that is a put option to sell currency, rather than a requirement to sell which a forward contract is. Technically, this is a non-linear derivative, because the payoff changes over time and space. This, by definition will cost something. An American option can be exercised at any time, whereas a European option can only be exercised on a particular date. Note that the cost of the option should be built into the project and bid cost. The option effectively sets a floor currency price for the bid, see Appendix III.

The company could also enter into two equal price put and call options to provide a "collar" around the exposure, without the out of pocket cost of a single option. These have also been called range forwards, forward-bands or cylinders. See Appendix II.

These options can be entered with over the counter (with a bank or broker) or in the futures markets.

As soon as the company finds it has won the bid, the company should enter into forwards to hedge the contract flows.

There are other more complicated and technical ways of dealing with bid risk, which this seminar does not deal with. A bank's foreign exchange desk can advise or an exchange broker, see Appendix V.

The company should probably develop a policy on bid risk and follow it every time bids or price quote situations are encountered. Practically speaking, it is probably not worth doing anything for the one week price quote periods.

Price list risk

The company also has currency risk with respect to the annual price list, which the Accounting Manager may not have realized. If the Canadian dollar increases in value relative to the U.S. dollar, the company will net less from the same sales. There are practical issues here. Does the company want to re-issue the list, with new prices every few weeks, months, days? Does the company want to pick an underlying assumed rate that is very conservative, which will protect itself against unfavourable movements, but which may result in lost business? There is no easy answer.

Controls over forwards

Currently, the accounting manager can phone the bank and enter into a forward contract verbally. This commitment is not immediately evidenced in the company. This commitment could damage the company and the company may not even be aware of the transaction, it doesn't get controlled and recorded immediately the way for example, cheque signing is controlled.

The company does not currently have a list of forwards contracts it has currently entered into, because the forwards are found here and there in files. She should always have a current list of forwards and their status, see Appendix II.

Improvements to this could be achieved by:

- Ensuring the bank has an approved list of who is authorized to enter into transactions
- Having all forwards approved by you, the Controller
- Having the bank immediately call an individual independent of the person who entered into the forward and is organizationally separate and send documentation on the transaction to this person (the "back office")

Budgeting

If the company can do some general budgeting, which it should, it must set a realistic budget rate as follows:

- Budget an average exchange rate that is a true representation of the value of the expected cash flow; and
- Build in a cushion to allow for cash flow differences keeping in mind that the hedging will likely be less than 100% effective.

Financial reporting

There are financial reporting implications of hedging, which we don't intend to cover in this case or course, see the relevant CICA Handbook Sections 3865. The main point of hedge accounting is that you can recognize the gains, losses, revenues and expenses associated with the various hedging relationships in the same period as the transaction, if they meet specified criteria.

Appendix I

Currency bid sheet

CURRENCY BID SHEET					
Amount	400,000.00	Currency	US	Transaction	Sell
Institution	Rate	Trans cost	Net	Winner	
RB	1.2268		490,708.00		
TD	1.2270		490,796.00	X	
Broker X	1.2268	\$25 wire	490,711.00		
Note: Tie goes to our banker					

Appendix II

Forward listing for RGC

Forward listing		Current rate	1.3264					
<u>Amount</u>	<u>Currency</u>	<u>Maturity</u>	<u>Inst</u>	<u>Buy</u>	<u>Sell</u>	<u>Rate</u>	<u>Yield</u>	<u>Marked to market</u>
224,500	USD	20-Dec-19	CMB	x		1.3257	297,611	175
80,000	USD	10-Jan-20	CMB		x	1.3261	106,086	-29
<u>76,000</u>	USD	10-Dec-19	CMB		x	1.3258	<u>100,759</u>	<u>-51</u>
<u>380,500</u>					Avg	1.3258	<u>504,456</u>	<u>95</u>

Appendix III

Example of collar to deal with bid risk

Bid risk							
480,000	Canadian approximate bid amount						
1.3264	Current rate						
361,871	USD						
	60 days	maturity					
Option							
Sell	361,871	in 60 days	at	1.3264	cost	26,425	rate is protected, there is a cost
If bid lost, do nothing							
If bid won, make \$ if rate is lower than 1.3264 and then enter forwards to protect transaction							
Cost is determined by bank's option-pricing model							
or							
Collar							
Option							
Sell	361,871	in 60 days	at	1.3514	cost	39,105	floor rate
Option							
Sell	361,871	in 60 days	at	1.3014	sell	39,105	ceiling rate
If bid lost, do nothing							
If bid won, make \$ if rate is outside range then enter forwards to protect transaction							
Cost are determined by bank's option-pricing model							

Appendix V

Some broker choices

- Calforex
- Travelex
- Cambridgefx
- Knightsbridgefx
- Western Union

SUGGESTED APPROACH CONSULTING AGREEMENT COMMENTS

Note:

This is a suggested approach, not a “correct” approach and it does not necessarily represent the only way the case could be handled.

CONSULTING CONTRACT

If in Quebec

Put in: The parties have expressly requested and required that this Agreement and all other related documents be drawn up in the English language. *Les parties conviennent et exigent expressément que ce Contrat et tous les documents qui s'y rapportent soient rédigés en anglais*

Legal entity

Make sure the contract is with the right legal entity. Those outside accounting and legal, often think it doesn't really matter.

Definitions

A list of definitions would make the contract clearer.

Start date

The contract needs a start date and possibly an end date (see termination clause discussion.) and possibly a renewal clause.

Work orders

Work orders will actually drive this whole contract. Sample work orders should be reviewed, since they are key.

Commission clause

The commission clause is highly unclear. Suppose the consultant brings some new business, in conjunction with a Larkman sales person? How long will commissions be paid, is it just that job, or all future revenues from the client or for a defined period? Is the commission based on revenue, signings or billings? When will the commission get paid? It would be best if they are paid only when Larkman collects from the end customer. These points should be clarified or there may be disputes. Does the consultant need to invoice the commission?

Non-solicitation clause

The contract really needs a non-solicitation clause, because the contractor could take business away from Larkman. An example would be as follows:

NON-SOLICITATION

You acknowledge that in consideration of your engagement by the Corporation pursuant to this letter and for a period of ninety (90) days after termination you shall not, directly or indirectly solicit, entice away or divert from the Corporation or provide work or services to:

- a) any of the customers or clients of the Corporation to whom you provided work during your engagement; or*
- b) or any employee, former employee, independent contractor or Consultant of the Corporation.*

Residency

We don't know if the individual is in fact a non-resident, which could have a number of tax and other implications, so this could be covered.

Not an employee

You want it be very clear that the consultant is not an employee, so you are less likely to run into employment law issues, so the contract should state this. In addition, you want to make the consultant responsible for withholding taxes. Note that generally for federal income tax and employment law purposes, it is a question of fact, whether the individual is an employee or an independent contractor. There are the four tests: integration, control, tools and risk of profit/loss. For Quebec, there are six tests: financial liability, ownership of tools, the degree to which your work is integral to the activities of your work provider, whether your work ends upon achieving a specific result, the agreement between the person and the work provider

A possible clause to deal with this would be:

Nothing contained in this letter and the relationship created between us shall, directly or indirectly, constitute you as agent or employee or servant of Corporation and further, nothing herein shall operate or be construed to relieve you of any duties or obligations imposed upon you as an independent contractor. You covenant and agree to indemnify the Corporation and save it harmless from and against all liabilities and claims whatsoever against the Corporation, including fines, penalties and interest thereon, for or by reason of or in any way arising out of its failure to deduct, withhold or contribute any amount in respect of its payments to you pursuant to this letter. Such liabilities and claims shall include, without limiting the generality of the foregoing, federal or provincial income taxes, excise tax, GS/HST, federal or provincial pension plan contributions, unemployment insurance premiums and contributions under any federal or provincial social insurance or income security programs.

However, if the contractor incorporates, the employee versus contractor issue generally goes away for both income taxes and employment law.

Currency

The currency is not specified in the contract. For greater certainty, it should be.

Insurance clauses

If the consultant is doing anything with liability or professional risks, it is a good idea to require the contractor to provide liability and/or errors & omissions (professional liability) insurance and proof thereof. However, practically speaking there are basically no such risks in an advertising agency arrangement. In addition, it is often difficult for individuals to find this kind of insurance cover.

Invoicing frequency

Invoicing frequency is not at all clear. Perhaps it should be monthly, to help with the company's tight cashflow.

Payment terms

Payment terms in the draft contract are "on a timely basis". This is unclear. Some clearly defined term like 30 days, would be more appropriate.

Hours cap

Larkman may want an hours cap in the contract.

Interest on late amounts

Consideration could be given to charges of interest on late amounts, but this would be normally be in favour of the contractor, so you might not want to raise it.

Rights and ownership

The contract should be clear how owns any intellectual property the consultant creates while consulting. It should of course be the corporation's the property. A clause like this would help:

Ownership of Property. All reports, plans, written proposals, and all other business information or products relating to the Corporation or its customers, prepared or produced by the Consultant in connection with the performance of Consultant's obligations hereunder shall be and remain the exclusive property of the Corporation.

GST

It is not clear whether GST/HST is included or not in the hourly rate. If the consultant is not to on the ball, they may be willing to be paid inclusive of GST/HST, with a clause like this:

All fees and payments shall be inclusive of any Goods and Services Tax (GST) or Harmonized Sales Tax (HST), that may be required to be charged under Canadian law by the Consultant.

Quality control and performance evaluation

Although they might be hard to define, some quality of work criteria should perhaps be set out in the agreement, for further clarification. For example, if the end customer doesn't like the consultant's work that should result in contractual implications, including termination. Is there some kind of performance evaluation feedback loop?

Authority to bind and agency

It might be a good idea to specify to what extent the contractor can represent and bind the company. Is the contractor an agent of the company?

Minimum hours

If there are no minimum hours, this should be clear.

Hold harmless

A clause that keeps Larkman free from the responsibility for the contractor's errors, would be useful and safer for the company.

Controls over contract operation

There is no requirement that the work orders get approved by a particular manager in Larkman, prior to payment.

Term and termination

The contract does not have an end date, or a clear termination clause. We would want to terminate the consultant easily if anything goes wrong. Having said that, if there is no current work order, the consultant will not be doing any work. An annual renewal clause would allow Larkman to refresh the terms.

The clause should also require the contractor to return any Larkman or customer materials, documents, etc., upon termination.

Both you and the Corporation understand and mutually agree that your engagement as a Consultant may be terminated at any time

- (a) *by the Corporation without notice or payment in lieu of notice:*
 - i) *for cause, including any material breach by you of the provisions of this letter or any Work Order or agreement, including the CONSULTANT AGREEMENT AS TO CONFIDENTIAL INFORMATION AND INTELLECTUAL PROPERTY, delivered pursuant to this letter;*

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- ii) *if you are not then providing work to the Corporation under a Work Order.*
 - iii) *if the Corporation is requested by its client or customer to replace you from work being provided by you to that client or customer;*
 - iv) *if the contract of the Corporation with its client or customer, under which your work is provided, terminates or ends for any reason;*
- (b) *by you without notice:*
- i) *for cause, including any material breach of this letter or any Work Order or agreement delivered pursuant to this letter by the Corporation;*
 - ii) *if you are not then providing, or are not contracted to provide at a future date, work under a Work Order;*
- c) *by either you or the Corporation for any reason and with or without cause, on not less than four (4) weeks written notice.*

Set-off clause

If ever the consultant owes the company money, it is better if there is a clause that lets the company deduct this from amounts owed by Larkman to the consultant.

You authorize the Corporation to deduct from any payment due to you at any time from any amounts owed to the Corporation.

Non-disclosure

The contract is missing a non-disclosure confidential information clause, the consultant could be handling sensitive information and should be bound not to disclose it. Legal advice should be sought on a watertight clause of this nature.

Arbitration, mediation or dispute clause

It is good to have a dispute resolution clause that goes to arbitration or mediation first, before an acceptable authority. Your lawyer can give you such a clause.

Tools and equipment

The contract should address the issue of who provides the tools and equipment the consultant is going to use, does he/she have to provide some of his/her own, e.g. a laptop? Will they get an office?

Location of work

The contract doesn't address where the work should be carried out.

Sub-contracting and assigning

If it is desirable, the contract should be clear that the consultant cannot sub out any of the responsibilities, nor can the contract be assigned to anyone else.

Expenses

The contract should be clear if the consultant will get reimbursed for items such as travel expenses.

Applicable law

The consultant wants the laws of Quebec to apply. If your company is not in Quebec, Quebec laws are somewhat different than the laws in the rest of Canada, so you would like the laws of your province to apply.

Retention of records

It would be best if the records retention period, was the same as the requirement for income taxes. For income tax, the six-year period starts at the end of the tax year to which the records relate

Other

It is not clear who the consultant reports to organizationally, within Larkman. This could be clarified.

The enurement clause is probably too harsh and unrealistic. The consultant's heirs will not be responsible for services under the agreement.

Worker Compensation laws vary by province, but you want a clause that deals with the responsibility for this, after consulting the applicable laws.

A clause that says the contract will comply the company's Privacy Policy and all applicable privacy laws would be good.

Whether Larkman wants the exclusive services of the contractor is not dealt with. Can the consultant compete with Larkman, between work orders. This restriction would be good, but it may not be reasonable to expect this, given the work schedule is undefined.

The consultant's address should be included.

Compliance with Larkman's and Larkman's customers' codes of conduct/ethics, harassment policies etc, should be addressed, and which one supersedes if there a contradiction. The contractor should know that bribes are not acceptable. Even dress and comportment at customer sites could be set out, if desired.

The generic clause, "this contract represents the entire agreement and any pre-signing oral discussions are not valid" is a popular one with lawyers.

Witnessing the signing of the contract may not be necessary, but it might be good for both signatories to the contract to initial each page.

Are there any strategic or tactical reasons why we are using an independent contractor like this, should we not use employees, which is better in the long run, should we switch this person to a full-time employee?

NOTES:

There are many very good contract template sites on the Internet, for example:

www.lawdepot.ca (free)

www.edilex.ca (not free)

INTERVIEWING CASE

Scenario 1 and Scenario 2 general points

The groups would be expected to develop 10 questions without the assistance of the seminar leader.

The focus should be on behavioural interviewing, considering past job behaviour as a better predictor of future behaviour, than hypothetical questions. Questions should be open-ended, rather than leading. Leading questions, “you like detailed work, don’t you” are nearly useless to confirm or deny if someone is good at doing detailed work.

Scenario 1 question ideas

Important: Don’t tell the candidate what qualities you are looking for

1. Describe your ideal job
2. Describe the kind of a job you would like least
3. What do you like/not like about your current position
4. Tell me your strengths and weaknesses – then ask for experiential support for strengths
5. Describe your favourite boss
6. Describe your worst boss
7. Tell me about the happiest moment in your career?
8. Did any of your construction clients play it “rough” with respect to income taxes or other areas?
9. Tell me about a situation you mishandled in the past and what you would do differently?
10. Why should we hire you?
11. What conditions will make you successful?
12. What do you tend to get stressed about at work?
13. What’s your world view?
14. Name three people you admire and why you admire them
15. It is 7 PM on a typical Friday night, what are you doing?
16. What did you learn in your last job?
17. What would your co-workers in your last job say about you? Can I call one of them?
18. Have you ever stolen office supplies from a previous employer
19. Describe the month end process in your last job
20. Explain the revenue recognition steps in your last job
21. Explain your role relative to your colleagues in your last job
22. Ask them how they would deal with a specific ethical dilemma?
23. What is the worst thing you have ever done?
24. What were your biggest accomplishments in the job?
25. What would your colleagues say about you?
26. When do you not follow the rules?
27. Ask about life’s choices and see what drives them
28. If I called your last boss, what would he/she say about you?
29. Describe a situation in your career where you were able to get things done faster
30. What would you do if we had to cut certain corners to achieve company objectives quickly?
31. What kind of procedure in a company do you find a pain to deal with?

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32. If you were an animal, what would it be?*
 33. Were any of your construction clients very profitable?
 34. Give examples of work experiences in your career which were satisfying? Unsatisfying?
 35. Give me three adjectives to describe you
 36. Tell me of an incident where you carried the ball alone for a previous employer
 37. What do you do during coffee breaks?
 38. What did you like least about your last job?
 39. Ask the references specifically about these qualities
 40. Ask them if they have ever been in an ethically difficult situation
 41. Tell me what you bring to the table for this job?
 42. What kind of things in jobs stress you?

*consult with human resources to ensure these questions do not violate any law, regulation or company policy

Scenario 2 question ideas

Some of the questions from Scenario 1 will apply

Note: consider how often they answer with I versus we, re the team player quality

1. Tell me the key success factor of your last two employers?
2. What did you learn in this job?
3. Describe your least favourite boss
4. Describe the kind of a job you would like least
5. What were your biggest accomplishments in these jobs?
6. Do you or have you played in any sports?*
7. What type of sports do you prefer?*
8. Give an example where you worked with a group in a previous employer to accomplish a goal
9. Describe a time or a situation at work where you felt it was necessary to modify or change your actions in order to respond to the needs of another person?
10. Where do you expect to be in five years?
11. I know who I want for this position, how can you get me to change my mind?
12. Have you ever “saved the day for your boss” ? If yes, describe the situation.
13. If you were not going after this job, what would you be doing?
14. What is the biggest work mistake you have ever made and what did you learn from it?
15. Discuss a problem scenario at work and see how they deal with it
16. In university on group work, how did your peers evaluate you?
17. If you were an animal, what would it be?*
18. What would your colleagues say about you?
19. What did you like most about your last job?
20. Why did you leave each of your jobs?
21. Give me three adjectives to describe you
22. Why did you leave each of your last three jobs?

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23. Why are you applying for this job?
 24. Ask the references specifically about these qualities
 25. Could we have a reference from two people who reported to you in the past
 26. If you were given \$2,000 for team-building activities, how would you spend it?
 27. What do you not like about supervising people?

*consult with human resources to ensure these questions do not violate any law, regulation or company policy