

**The North York Performing Arts Centre  
Corporation**  
(operating as the “Toronto Centre for the Arts”)

Report to the Audit Committee  
for the year ended  
December 31, 2010

April 21, 2011

Members of the Audit Committee  
The North York Performing Arts Centre Corporation  
(operating as Toronto Centre for the Arts)

Dear Audit Committee Members,

We have substantially completed our audit of the financial statements of North York Performing Arts Centre Corporation (operating as the Toronto Centre for the Arts - TCA) for the year ended December 31, 2010 and propose to issue an unqualified report on those financial statements, pending resolution of outstanding items outlined on page 1. Our draft auditors' report is included as Appendix A.

We have issued the accompanying report to assist you in your review of the financial statements. It includes an update on the status of our work as well as a discussion on the significant accounting and financial reporting issues dealt with during the audit process.

We propose to review the key elements of this report at the upcoming meeting and discuss with your audit committee our key findings.

We would like to express our sincere thanks to the management and the staff of TCA who have assisted us in carrying out our work and we look forward to our meeting on May 2, 2011. Should you have any questions or concerns prior to the audit committee meeting, please do not hesitate to contact me in advance.

Yours very truly,

*PricewaterhouseCoopers LLP*

Sara Oates  
Associate Partner – Not-for-Profit Services  
Audit and Assurance Group

cc: Pim Schotanus, General Manager

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The matters raised in this and other reports that will flow from the audit are only those that have come to our attention arising from or relevant to our audit that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising and, in particular, we cannot be held responsible for reporting all risks in your business or all internal control weaknesses. This report has been prepared solely for your use and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted, as the report has not been prepared for, and is not intended for, any other purpose. Comments and conclusions should only be taken in context of the financial statements as a whole as we do not mean to express an opinion on any individual item or accounting estimate.

## 1. Executive summary

### a. Status of the audit

We have substantially completed our audit of the 2010 financial statements. Our audit report will be issued once we receive and have completed our audit work on the outstanding items noted below.

Our audit has been performed substantially in accordance with the plan and timeline previously communicated to you. The following items will need to be completed / received prior to the issuance of our opinion. We will provide an update on the status of these items at our upcoming meeting.

Outstanding items	Status as at May 2, 2011
i. Review of final cost listing of art collection reconciled to the financial statements	
ii. Confirmation from City re: no demand payment of loan within the next year	
iii. Subsequent events update with management	
iv. Receipt of signed management representation letter	
v. Approval of the financial statements by the audit committee	

### b. Key issues for discussion

The following is a summary of the key audit and financial reporting issues we discussed with management during the audit. Further details on each issue can be found within this document.

	Issue	Summary discussion	For further reference
i.	Significant audit and accounting matters	<p>We identified several areas of focus in our audit plan. We will provide an update to the audit committee on the following areas:</p> <ul style="list-style-type: none"> <li>o Employee future benefits</li> <li>o Capital assets</li> <li>o Deferred revenue</li> <li>o Payroll cycle</li> <li>o Management estimates</li> <li>o Treatment of related party transactions</li> </ul>	Section 2
ii.	Summary of unadjusted and adjusted items	<ul style="list-style-type: none"> <li>o We identified one unadjusted item during the audit. As a result, the deficit is overstated by \$6,309 as compared to overall materiality of \$110,000. In our opinion, the financial statements, taken as a whole, are free of material misstatement.</li> </ul>	Section 3

	<b>Issue</b>	<b>Summary discussion</b>	<b>For further reference</b>
iii.	Control deficiencies	<ul style="list-style-type: none"><li>• We have discussed recommendations with respect to internal controls in the following areas:<ul style="list-style-type: none"><li>◦ Management expense report approval and written policies</li><li>◦ Review of employee payroll reconciliations</li><li>◦ Employee termination policy</li><li>◦ Petty cash policy or control log</li><li>◦ Approval for capital purchase invoice over \$50K</li><li>◦ Cash held in-trust</li><li>◦ Overall segregation of duties</li></ul></li></ul>	Section 5
iv.	Independence	<ul style="list-style-type: none"><li>• We confirm that we are independent of the Toronto Centre for the Arts as at December 31, 2010, and our independence letter can be found in Appendix C.</li></ul>	Appendix C

## 2. Significant audit, accounting and financial reporting matters

The preparation of the financial statements under Canadian generally accepted accounting principles (GAAP) requires management to select accounting policies as well as make critical accounting estimates and disclosures that involve significant judgment and measurement uncertainty, which can significantly impact the organization's reported results.

We are responsible for discussing with the audit committee our views about the significant qualitative aspects of the organization's accounting practices, including the appropriateness of accounting policies, the reasonability of key accounting estimates and judgments, as well as the adequacy of financial statement disclosures.

Our comments and conclusions included in this report should only be taken in the context of the financial statements as a whole and are not meant to express an opinion on any individual item or accounting estimate.

During the audit, we discussed the following items with management:

Issue	Discussion
Treatment of related party transactions	<p>As a significant amount of activity occurs between the City and the Centre, we confirmed all year-end balances directly with the City, related to the grant, loan payable, receivable, the Capital Maintenance Reserve Fund and the Stabilization Reserve fund.</p> <p>Based on our review of the confirmation received, all amounts have been accurately and completely reflected in the financial statements and accounts of TCA.</p> <p>As part of our controls testing, we also reviewed the business performance review controls of TCA, focused on quarterly reporting with the city. As a result of our controls work, no significant issues were noted.</p>
Deferred capital contributions and advance ticket sales	<p>At year-end, we tested a sample of amounts included as deferred capital contributions to ensure that they related to future investment of capital for TCA. Capital investment fund ticket surcharges (CIF) ranging from \$0.50 to \$1.80 per ticket sold, depending on the use of the Main Stage, Recital Hall or Studio Theatre. Our testing indicated that the sample tested had been accurately recorded and deferred at year end as available to the centre for future capital investment.</p> <p>Deferred revenues (which include deposits from the various license agreements which have not yet been earned) and advance ticket sales were both tested on a sample basis to underlying records - no exceptions were noted.</p>
License agreement and presentation of Dancap revenues and expenses	<p>At the year end, TCA had recognized revenues of \$2,832K, expenses of \$127K, and payables of \$145K relating to the agreement with Dancap. Due to the significance of Dancap Production Inc.'s activities at TCA, we reviewed the license agreement between the Centre and Dancap to ensure that revenues and related expenses had been accurately and appropriately recognized – no exceptions were noted. All amounts were confirmed</p>

Issue	Discussion
	<p>directly with Dancap, without exception. The Centre is required to rebate (credit) the revenues earned by Dancap for volume discounts, ancillary package rebates, and Dancap tax rebates, amounting to \$127K in the current year. We reviewed this amount in TCA's records, and confirmed directly with Dancap to assess the completeness and accuracy of this rebate. Amounts sampled were accurately reflected in the general ledger.</p> <p>We discussed with management the appropriate presentation of the rebates earned by Dancap, considering the requirements of <i>EIC 156 – Accounting by a vendor for consideration given to a customer</i>. This guidance requires that, in situations where cash consideration (including a sales incentive such as a rebate) given by a vendor to a customer is presumed to be a reduction of the selling prices of the vendor's products or services and, therefore, the amounts should be recorded as a reduction of revenue when recognized in the vendor's income statement.</p> <p>Based on our review of the agreement and discussions with management, we have concluded that it is therefore appropriate to reflect the rebates of \$127K a reduction of revenue from operations. Consequently, this has been reflected in the financial statements (see summary of adjusted items in section 3).</p> <p>We have also confirmed that the comparatives have been prepared on a consistent basis.</p>
Art collection	<p>As part of our audit procedures related to the art collection, we visited the warehouse where the art collection was stored. On a sample basis, we tested a sample of collection items from the warehouse to the Centre's listing of items to get comfort over the completeness of the items recorded. We also observed a sample of items from the listing to the items in the warehouse, to get comfort over the accuracy of the reported collection. No exceptions were noted.</p> <p>We have also requested a detailed breakdown of the amount recorded for the art collection in the financial statements. Review of this item is currently outstanding.</p>
Canadian Song Writer's Hall of Fame (CSHF)	<p>We reviewed the terms of the memorandum of understanding with CSHF and TCA to pursue mutually approved initiatives. Initiatives include the development and operation of a hall of fame exhibition, and hosting a minimum number of events in each of 2010, 2011 and 2012.</p> <p>We tested the contribution payments for the three 2010 events hosted. The maximum six events for fiscal 2010 was not exceeded. Our testing of the contribution payments indicated that amounts were accurately and completely paid by TCA.</p>
Payroll cycle	<p>We reviewed the key controls over the payroll cycle to ensure effective functioning on a continuous basis. We also performed analytical review procedures on amounts recorded for full-time staff and detailed testing of amounts recorded for contract and union staff. No exceptions were noted.</p>

### 3. Summary of unadjusted and adjusted items

Our responsibility is to issue an opinion as to whether the financial statements are free of material misstatement.

As a result of our audit, we identified certain items and have discussed these with management. Management has adjusted the financial statements to reflect certain of these items. The items that remain unadjusted are summarized in (a) below. Under Canadian Auditing Standards we are required to ask the Audit Committee to consider adjusting the financial statements for these items.

We are also required to communicate the effects of any unadjusted items that relate to prior periods. We did not note any such effects.

#### a. Unadjusted items

Total unadjusted items have a net effect decreasing the deficit from operations by \$6,309. The materiality level (as previously communicated to you) is \$110,000.

Description	Excess of revenue over expense	Statement of financial position		
		Assets (over) under stated	Liabilities over (under) stated	Net assets over (under) stated
To adjust a deferred amount to revenue from operations	(6,309)	-	6,309	-
<b>Total unadjusted differences</b>	<b>(6,309)</b>	<b>-</b>	<b>6,309</b>	<b>-</b>

## b. Adjusted items

The following items have been reflected in the financial statements:

Description	Excess of revenue over expense	Statement of financial position		
	Over (under) stated	Assets (over) under stated	Liabilities over (under) stated	Net assets over (under) stated
To net the HST receivables and payables at year end.	-	(25,394)	25,394	-
To reclassify cash to cash held in-trust	-	(34,340) 34,340	-	-
To adjust withdrawal from stabilization reserve fund as a reduction of fund balances	(49,232)	-	-	49,232
To recognize rebates on Dancap sales on a net basis	127,287 (127,287)			
<b>Total adjusted differences</b>	<b>(49,232)</b>	<b>(25,394)</b>	<b>25,394</b>	<b>49,232</b>

## 4. Other required communications

Canadian Auditing Standards require that the external auditor communicate certain matters to the audit committee that may assist you in overseeing management's financial reporting and disclosure process.

Below, we summarize these required communications as they apply to the Toronto Centre for the Arts Centre Corporation:

<b>Matter to be communicated</b>	<b>PwC's response</b>
Significant difficulties or disagreements that occurred during the audit	<ul style="list-style-type: none"> <li>• No difficulties or disagreements occurred while performing our audit that require the attention of the audit committee.</li> </ul>
Fraud and illegal acts	<ul style="list-style-type: none"> <li>• No fraud involving senior management, employees with a significant role in internal control, or that would cause a material misstatement of the financial statements, came to our attention as a result of our audit procedures.</li> <li>• We wish to reconfirm whether the audit committee is aware of any known, suspected or alleged incidents of fraud.</li> </ul>

## 5. Internal control recommendations

The purpose of our audit was to enable us to express an opinion on the financial statements.

The audit included consideration of internal controls relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control.

During our audit, we discussed the following control recommendations with management

Observation	Recommendation	Management's response
<p><b>Management expense report approval and written policies</b></p> <p>During our testing of the authorization of management expense reports, we noted one instance where a manager had approved his own American Express (Amex) expense report. Although our review indicated that the nature of the expense approved was in accordance with policy, there is a risk of misappropriation of assets where expense reports can be self-approved.</p>	<p>We recommend that all expense reports, including Amex expenses, be approved by someone other than the manager who has incurred the expense.</p> <p>Management has already developed a policy with respect to the use and approval of credit card related expenses. We recommend that this policy be updated to include the appropriate signature authorization policy.</p>	<p>Management agrees that no manager will be able to approve their own Amex expense reports going forward.</p> <p>The new credit card policy will also be updated to include the appropriate signature authorization policy.</p>
<p><b>Review of employee payroll reconciliations</b></p> <p>As part of our controls testing at year end, we examined the preparation and review of the monthly payroll reconciliations from the general ledger to the ADP service provider report.</p> <p>In the fourth quarter we noted that the reconciliations were not formally reviewed as required by TCA policy, as a payroll staff member had been terminated, requiring the General Manager to prepare the reconciliations.</p>	<p>We recommend that a different manager prepare the reconciliation from the manager who evidences review of the reconciliation. This is particularly important during a period of transition of payroll staff, as the risk of human error may be increased.</p>	<p>Management agrees that during a period of transition, the reconciliation will be prepared by a different manager from the manager who evidences review of the reconciliation.</p>

Observation	Recommendation	Management's response
<p><b>Employee termination policy</b></p> <p>In our testing of controls over the payroll cycle, we noted that the Centre does not currently have a process to ensure that all terminated employees are removed from the system on a timely basis. The information is currently provided on an ad hoc basis to the payroll administrator and no record is kept of changes or the related approvals. This increases the risk of overpaying a terminated employee who has not been removed from the system on a timely basis.</p>	<p>We recommend that the payroll administrator and human resources manager implement the use of standing data change forms for terminations, new hires and salary changes. A standardized form for each of these significant changes to the payroll register can reduce the risk of overpayment and increase the ability for management to track significant dates, appropriate authorization and other pertinent information.</p>	<p>Management has agreed to the recommendation and will begin implementing these procedures on a going forward basis.</p>
<p><b>Lack of petty cash policy or control log</b></p> <p>Currently, there is no formal policy in place for managing petty cash. Petty cash is approximately \$10k at year-end.</p>	<p>We recommend implementing a formal policy for managing petty cash. This could include a control log of petty cash use, by person, date and amount. We also recommend that this log be reconciled and viewed on a regular basis.</p>	<p>Most significant expenses are incurred through Amex credit card use. However, TCA aims to create a policy for employees that will help ensure petty cash is being managed appropriately.</p> <p>Management agrees to implement a control log system for petty cash use. Moreover, a reconciliation of these funds will be performed to this log at the end of each month.</p>
<p><b>Approval for capital purchase invoice over \$50K</b></p> <p>During the course of our work, we noted two cheque payments for approximately 30k each, related to one invoice for \$60K. TCA's current expense policy requires all invoices in excess of \$50K be signed by TCA management and Chair of the Board. Although the capital purchase was reasonable, this control was not effectively adhered to according to policy.</p>	<p>We recommend that the current control policy be maintained at TCA, and the secondary approver requirement not be bypassed. As the purpose of this control is to protect the Centre from the misappropriation of assets, as well as keeping the Board informed of significant expenditures, we recommend that planning for authorization of significant expenditures be planned and communicated to the Board Chair on a timely basis.</p>	<p>Management has identified this as an isolated event. The payment of this invoice was time sensitive, resulting in difficulty in obtaining authorization from the Chair.</p> <p>Management agrees with the recommendation and maintenance of this control.</p>

Observation	Recommendation	Management's response
<p><b>Cash held in trust</b></p> <p>The agreement with Dancap requires that the Centre's box office sales received related to Dancap sales be segregated in a bank trust account. Based on the Ticket Master box office report for year-end, the amount expected in-trust is approximately \$47K. We understand that this is usually performed by the Director of Finance and Administration, but in his absence during the year-end vacation, this transfer was overlooked.</p>	<p>We recommend that the amount in-trust be reviewed, in the absence of the Director of Finance and Administration, by either the General Manager or the Director of Operations. This will ensure that the appropriate funds are transferred to the trust account on a timely basis, and that the financial statements reflect the interests of one of its key users, Dancap Productions Inc.</p>	<p>Management agrees with this recommendation.</p>
<p><b>Overall segregation of duties</b></p> <p>Due to the size of the Centre, we noted many areas where the reporting and accounting functions are performed by the General Manager. This increases the risk of error and possibility for management override of controls.</p>	<p>We recommend that the General Manager delegate certain responsibilities to the Director of Finance and Administration the Director of Operations, and/or other capable staff, with the appropriate training. This will enable the General Manager to independently review the work prepared by these staff. We noted instances where this was beginning to happen. We encourage a full review of all roles and responsibilities to ensure this ability has been maximized.</p>	<p>Management has already begun to delegate responsibilities where possible. For example, the Director of Finance and Administration took on a much larger role in preparing the audit requirements, as well as certain accounting processes.</p>

## Appendix A: Draft auditor's report and draft financial statements

**The North York Performing Arts  
Centre Corporation**

(operating as The Toronto Centre for the Arts)

Financial Statements  
**December 31, 2010**

**DRAFT**

**FOR DISCUSSION WITH MANAGEMENT ONLY – SUBJECT TO AMENDMENT  
NOT TO BE FURTHER COMMUNICATED**

May @@, 2011

**Independent Auditor's Report**

**To the Directors of  
The North York Performing Arts Centre Corporation**  
(operating as The Toronto Centre for the Arts)

We have audited the accompanying financial statements of The North York Performing Arts Centre Corporation (operating as The Toronto Centre for the Arts), which comprise the balance sheet as at December 31, 2010 and the statements of operations and deficit and cash flows for the year then ended, and the related notes including a summary of significant accounting policies.

**Management's responsibility for the financial statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**FOR DISCUSSION WITH MANAGEMENT ONLY – SUBJECT TO AMENDMENT  
NOT TO BE FURTHER COMMUNICATED**

**Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of The North York Performing Arts Centre Corporation (operating as The Toronto Centre for the Arts) as at December 31, 2010 and the results of operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

**Other matter**

The prior year's financial statements were audited by another firm of chartered accountants who expressed a unqualified opinion in their report dated March 12, 2010.

**Chartered Accountants, Licensed Public Accountants**

DRAFT

**FOR DISCUSSION WITH MANAGEMENT ONLY – SUBJECT TO AMENDMENT  
NOT TO BE FURTHER COMMUNICATED**

# The North York Performing Arts Centre Corporation

(operating as The Toronto Centre for the Arts)

Balance Sheet

As at December 31, 2010

(in thousands of dollars)

	2010 \$	2009 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash	316	2,514
Cash held in trust (note 4)	47	180
Accounts receivable (note 10)	149	34
Prepaid expenses	13	13
	525	2,741
<b>Receivable from the City of Toronto</b> (note 3(a))	4,558	3,077
<b>Art collection</b>	2,542	2,542
<b>Capital assets</b> (note 5)	28,067	28,604
<b>Total Assets</b>	35,692	36,964
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	484	939
Deferred revenue	149	279
Advance ticket sales	247	285
	880	1,503
<b>Loan payable to the City of Toronto</b> (note 3(c))	10,023	10,023
<b>Deferred capital contributions</b> (note 6)	28,165	28,485
<b>Total Liabilities</b>	39,068	40,011
<b>Deficit</b>	(3,376)	(3,047)
	35,692	36,964

On Behalf of the Board

\_\_\_\_\_ Director

\_\_\_\_\_ Director

**FOR DISCUSSION WITH MANAGEMENT ONLY – SUBJECT TO AMENDMENT  
NOT TO BE FURTHER COMMUNICATED**

# The North York Performing Arts Centre Corporation

(operating as The Toronto Centre for the Arts)

Statement of Operations and Deficit

For the year ended December 31, 2010

(in thousands of dollars)

	<u>2010</u>	<u>2009</u>
	<b>Budget</b> \$ (Unaudited)	<b>Actual</b> \$ <b>Actual</b> \$
<b>Revenue</b>		
Revenue from operations (note 4)	3,380	5,074
City of Toronto grant	980	980
Amortization of deferred capital contributions	-	1,036
Other recoveries	-	78
	<u>4,360</u>	<u>7,168</u>
<b>Expenses</b>		
Salaries, wages and benefits (note 8)	2,878	4,118
Capital maintenance	74	202
Utilities	455	416
Other operating	914	1,400
Professional fees and services	39	23
Amortization of capital assets	-	1,365
	<u>4,360</u>	<u>7,524</u>
<b>Excess of revenue over expenses (expenses over revenue) before the following</b>	-	(356)
<b>Transfer to the City of Toronto</b> (note 3(d))	-	(21)
<b>Transfer from the Stabilization Reserve Fund</b> (note 7)	-	48
<b>Excess of expenses over revenue for the year</b>	-	(329)
<b>Deficit - Beginning of year</b>	-	(3,047)
<b>Deficit - End of year</b>	-	(3,376)

**FOR DISCUSSION WITH MANAGEMENT ONLY – SUBJECT TO AMENDMENT  
NOT TO BE FURTHER COMMUNICATED**

# The North York Performing Arts Centre Corporation

(operating as The Toronto Centre for the Arts)

Statement of Cash Flows

For the year ended December 31, 2010

(in thousands of dollars)

	2010 \$	2009 \$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Excess of expenses over revenue for the year	(329)	(329)
Add (deduct) non-cash items		
Amortization of deferred capital contributions	(1,036)	(990)
Amortization of capital assets	1,365	1,319
Net change in non-cash working capital balances (note 9)	(605)	684
	<u>(605)</u>	<u>684</u>
<b>Investing activities</b>		
(Decrease) increase in receivable from the City of Toronto (note 9)	(1,453)	442
Purchase of capital assets	(828)	(583)
	<u>(2,281)</u>	<u>(141)</u>
<b>Financing activities</b>		
Capital Maintenance Reserve Fund - ticket surcharges (note 6(b))	688	983
<b>(Decrease) increase in cash during the year</b>	<u>(2,198)</u>	<u>1,526</u>
<b>Cash - Beginning of year</b>	<u>2,514</u>	<u>988</u>
<b>Cash - End of year</b>	<u>316</u>	<u>2,514</u>

**FOR DISCUSSION WITH MANAGEMENT ONLY – SUBJECT TO AMENDMENT  
NOT TO BE FURTHER COMMUNICATED**

# The North York Performing Arts Centre Corporation

(operating as The Toronto Centre for the Arts)

Notes to Financial Statements

December 31, 2010

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(in thousands of dollars)

## 1 Purpose

The North York Performing Arts Centre Corporation (the Centre) was incorporated on June 29, 1988 without share capital by Special Act (City of North York Act, 1988 (No. 2), Statutes of Ontario 1988, Pr45). The Centre is a local board of the City of Toronto (the City) and is a non-profit organization incorporated to maintain, operate and manage The Centre as an artistic, cultural, social, educational and recreational facility for the benefit of the City and its inhabitants and in the public interest. The Centre includes the Main Stage Theatre, the George Weston Recital Hall and the Studio Theatre.

The Centre is exempt from income taxes under Section 149(1) of the Income Tax Act (Canada).

## 2 Summary of significant accounting policies

The financial statements of the Centre have been prepared by management in accordance with Canadian generally accepted accounting principles. The significant accounting policies are as follows.

### Revenue recognition

The Centre follows the deferral method of accounting for contributions, which includes grants. Unrestricted contributions are recognized as revenue when received or receivable if the amount to be received can be reasonably estimated and collection is reasonably assured.

Restricted contributions are deferred and recognized as revenue in the year in which the related expenses are incurred. Externally restricted contributions for depreciable capital assets are deferred and amortized over the life of the related capital asset. Externally restricted contributions for capital assets that have not been expended are recorded as capital contributions on the balance sheet.

Deferred revenue consists of deposits for rental revenue and deposits for costs to be incurred and recovered by the Centre for future performances. Once the performances occur, the deposits are recorded as revenue from operations.

Other revenue is recognized when earned, which may be on the date of the performance or point of sale.

### Advance ticket sales

Advance ticket sales represent funds received from tickets sold prior to December 31 for performances presented by rental clients in the following year. Once the performance has occurred, the advance ticket sales net of certain box office charges including ticket surcharges are payable to the rental clients and are included in accounts payable.

**FOR DISCUSSION WITH MANAGEMENT ONLY – SUBJECT TO AMENDMENT  
NOT TO BE FURTHER COMMUNICATED**

# The North York Performing Arts Centre Corporation

(operating as The Toronto Centre for the Arts)

Notes to Financial Statements

December 31, 2010

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(in thousands of dollars)

## Capital assets

Capital assets are recorded at cost and are amortized on a straight-line basis over their estimated useful lives as follows:

Building	40 years
Furnishings and equipment	12 years
Computer equipment	3 years

Land on which the building and major capital facilities are located is owned by Ontario Power Generation.

## Art collection and gallery

Works purchased for exhibition in the Museum of Canadian Contemporary Art are recorded on the balance sheet at cost. Works donated are independently appraised and are recorded on the balance sheet at their appraised value.

## Employee future benefits

Defined contribution plan accounting is applied to a multi-employer defined benefit pension plan. Contributions are expensed when due.

## Derivatives

Derivative contracts entered into by the City for electricity, which the Centre is a party to, are not designated to be in a hedging relationship and are recorded on the balance sheet at their fair value as an asset or liability based on quoted market prices or dealer quotes with changes in fair value recorded in utilities expenses on the statement of operations and deficit.

## Financial instruments

The carrying values of the Centre's financial instruments approximate their fair values unless otherwise noted.

The Centre has chosen to continue to apply The Canadian Institute of Chartered Accountants (CICA) Handbook Section 3861, Financial Instruments - Disclosure and Presentation, in place of Section 3862, Financial Instruments - Disclosures, and Section 3863, Financial Instruments - Presentation.

## Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**FOR DISCUSSION WITH MANAGEMENT ONLY – SUBJECT TO AMENDMENT  
NOT TO BE FURTHER COMMUNICATED**

# The North York Performing Arts Centre Corporation

(operating as The Toronto Centre for the Arts)

Notes to Financial Statements

December 31, 2010

(in thousands of dollars)

## 3 Related party transactions, City of Toronto

- a) The Centre manages its cash flows independent of the City, except for the investment of the Capital Maintenance Reserve Fund (note 6(b)). The receivable from the City, which is non-interest bearing, represents the cumulative excess of cash received and disbursements made directly by the City on behalf of the Centre. The fair value of this receivable cannot be reasonably determined as there are no fixed terms of repayment.
- b) In the normal course of operations, the Centre incurs costs for various expenses payable to the City such as hydro, legal and other administrative costs. Transactions between the City and the Centre are made at the agreed upon exchange amount. In the current year, hydro energy services purchased during the year amounted to \$340,422 (2009 - \$@@@).
- c) Capital financing for the construction of the Centre was provided by the former City of North York prior to 1994 in the amount of \$10,023 (2009 - \$10,023). The loan payable is non-interest bearing. The fair value of this loan payable cannot be reasonably determined as there are no fixed terms of repayment. The City has indicated that it will not demand payment of this loan within the next year.
- d) The transfer of operating income to the City is calculated as follows:

	2010 \$	2009 \$
Excess (deficiency) of revenue over expenses before transfer to the City of Toronto	(356)	32
Transfer from the Stabilization Fund	48	-
Add (deduct): Non-cash items		
Amortization of capital assets	1,365	1,319
Amortization of deferred capital contributions	(1,036)	(990)
	<hr/>	<hr/>
Transfer to the City of Toronto	21	361
	<hr/>	<hr/>

## 4 Licence agreement

On December 21, 2007, the Centre entered into a licence agreement for the use of the Centre's Main Stage Theatre for certain performances from August 4, 2008 to January 11, 2009. On January 9, 2009, the agreement was extended for an indefinite period of time. In addition to the rental fee, the licensee is required to pay for certain costs specific to their use of the Main Stage Theatre.

On March 7, 2008, the Centre and the licensee entered into a Master Licence Agreement from the date of the agreement until December 31, 2010, providing the licensee first right to use the premises, including the Main Stage Theatre. In addition to the rental fee, the licensee is required to pay for certain costs specific to their use of the Main Stage Theatre. On January 9, 2009, this agreement was extended to the later of December 31, 2011 or the last day of the licence agreement noted above. The licensee guarantees the Centre a minimum rental fee of \$500 for each of the fiscal years 2009 through 2011. There is a letter of credit outstanding at December 31, 2010 in connection with this agreement of \$500 (2009 - \$750).

**FOR DISCUSSION WITH MANAGEMENT ONLY – SUBJECT TO AMENDMENT  
NOT TO BE FURTHER COMMUNICATED**

(3)

# The North York Performing Arts Centre Corporation

(operating as The Toronto Centre for the Arts)

Notes to Financial Statements

December 31, 2010

(in thousands of dollars)

The Centre has agreed to make certain rebate payments to the licensee based on the number of performance days and revenue.

All proceeds from the sale of tickets at the Centre pertaining to these agreements are to be held in trust until the completion of the applicable performance, at which time the ticket proceeds for that performance are paid to the licensee. As at December 31, 2010, \$47 (2009 - \$180) of advance ticket sales was held in trust.

## 5 Capital assets

Capital assets consist of the following:

			<b>2010</b>
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
	\$	\$	\$
Building	45,649	19,451	26,198
Furnishings and equipment	4,414	2,589	1,825
Computer equipment	296	252	44
	<b>50,359</b>	<b>22,292</b>	<b>28,067</b>
			<b>2009</b>
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net</b>
	\$	\$	\$
Building	45,612	18,310	27,302
Furnishings and equipment	3,657	2,404	1,253
Computer equipment	262	213	49
	<b>49,531</b>	<b>20,927</b>	<b>28,604</b>

**FOR DISCUSSION WITH MANAGEMENT ONLY – SUBJECT TO AMENDMENT  
NOT TO BE FURTHER COMMUNICATED**

# The North York Performing Arts Centre Corporation

Notes to Financial Statements

December 31, 2010

(in thousands of dollars)

## 6 Deferred capital contributions

The changes in deferred capital contributions during the year are due to the following:

	<b>2010</b>	<b>2009</b>		
	<b>Capital Maintenance Reserve Fund \$</b>	<b>Other capital contributions \$</b>	<b>Total \$</b>	<b>Total \$</b>
Balance - Beginning of year	8,013	20,472	28,485	28,455
Ticket surcharge	688	-	688	983
Interest earned	28	-	28	37
Purchase of capital assets funded	(828)	828	-	-
Amortization of deferred capital contributions	-	(1,036)	(1,036)	(990)
Balance - End of year	7,901	20,264	28,165	28,485

The Capital Maintenance Reserve Fund, which consists of unspent capital ticket surcharges, is invested by the City. The capital surcharge on the sale of tickets for performances is considered to be externally restricted with the funds and interest earned on the funds only to be used for capital improvements of the Centre.

**The North York Performing Arts Centre Corporation**

Notes to Financial Statements

**December 31, 2010**

(in thousands of dollars)

At the year-end, capital contributions consist of the following:

	<b>2010</b>	<b>2009</b>		
	<b>Capital Maintenance Reserve Fund \$</b>	<b>Other capital contributions \$</b>	<b>Total \$</b>	<b>Total \$</b>
Gross capital contributions received from the City	-	30,660	30,660	30,660
Other	-	10,325	10,325	9,496
Capital Maintenance Reserve Fund	7,900	-	7,900	8,013
	7,900	40,985	48,885	48,169
Less: Accumulated amortization	-	20,720	20,720	19,684
	7,900	20,265	28,165	28,485

# The North York Performing Arts Centre Corporation

Notes to Financial Statements

December 31, 2010

(in thousands of dollars)

## 7 Stabilization reserve

During 2003, the Centre entered into an agreement with the City that established in the accounts of the City, The North York Performing Arts Centre Corporation Operating Stabilization Reserve Fund (the Stabilization Reserve Fund) for the purpose of putting aside income earned in profitable years in order to offset deficits in other years. This agreement provided that transfers were to be made to the Stabilization Reserve Fund based on the cash basis of accounting and therefore exclude amortization. Beginning with the year ended December 31, 2006, the transfer of the current year operating income is no longer automatically added to the Stabilization Reserve Fund. The transfer is only added to this fund if approved by the City Council. For the fiscal years ended December 31, 2008 and 2009, the City has not added to this fund the transfer of current year operating income as disclosed in note 3(d). Effective January 1, 2008, the fund was converted to a reserve and no longer earns investment income. As at December 31, 2010, the balance in the Stabilization Reserve is \$1,225 (2009 - \$1,275).

## 8 Employee benefits

The Centre makes contributions to the Ontario Municipal Employees Retirement Fund (OMERS), which is a multi-employer pension plan, on behalf of most of its employees. The plan is a defined benefit plan, which specifies the amount of the retirement benefit to be received by the employees based on the length of service and rates of pay. Employees and employers contribute jointly to the plan.

Because OMERS is a multi-employer pension plan, any pension plan surpluses or deficits are a joint responsibility of all Ontario municipalities and their employees. As a result, the Centre does not recognize any share of the OMERS pension surplus or deficit. Employers' current service contributions to the OMERS pension plan in 2010, which were expensed, are \$55 (2009 - \$54) and are included in salaries, wages and benefits.

In addition to the OMERS plan, the Centre has arrangements with bargaining units to make contributions to registered retirement savings plans on behalf of its employees that are not participating in OMERS. Contributions expensed in connection with these plans for 2010 amounted to \$106 (2009 - \$127) and are included in salaries, wages and benefits.

## 9 Statement of cash flows

The net change in non-cash working capital balances related to operations consists of the following:

	2010	2009
	\$	\$
Funds held in trust	133	59
Accounts receivable	(115)	77
Prepaid expenses	-	15
Accounts payable and accrued liabilities	(455)	595
Deferred revenue	(130)	7
Advance ticket sales	(38)	(69)
	<u>(605)</u>	<u>684</u>

**FOR DISCUSSION WITH MANAGEMENT ONLY – SUBJECT TO AMENDMENT  
NOT TO BE FURTHER COMMUNICATED**

(7)

# The North York Performing Arts Centre Corporation

Notes to Financial Statements

December 31, 2010

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(in thousands of dollars)

Non-cash investing and financing activities excluded from the statement of cash flows include interest earned on the Capital Maintenance Reserve Fund of \$27 (2009 - \$37) (note 6(b)), which is included in the receivable from the City of Toronto.

## 10 Financial instruments

The Centre is exposed to changes in electricity prices associated with a wholesale spot market for electricity in Ontario. The Centre has addressed the commodity price risk exposure associated with changes in the wholesale price of electricity by entering into energy related purchase and sales contracts, through their participation in an agreement entered into by the City that fixes a portion of the wholesale price over the term of the contract. All contracts entered into in 2009 expired by December 31, 2009. There were no contracts entered into in 2010.

The Centre is subject to credit risk with respect to accounts receivable of \$149. As at December 31, 2010, three accounts represent 93% of the total accounts receivable balance (2009 - two accounts represented 80%). Revenue derived from one customer totalled 71% of revenue from operations (2009 - one customer totalled 71%).

## 11 Capital management

In managing capital, the Centre focuses on liquid resources available for operations. The Centre's objective is to have sufficient liquid resources to continue operating despite adverse financial events and to provide it with the flexibility to take advantage of opportunities that will advance its purposes. The need for sufficient liquid resources is considered in the preparation of an annual budget and in the monitoring of cash flows and actual operating results compared to the budget. As at December 31, 2010, the Centre has met its objective of having sufficient liquid resources to meet its current obligations.

## 12 Comparative figures

Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current year.

**FOR DISCUSSION WITH MANAGEMENT ONLY – SUBJECT TO AMENDMENT  
NOT TO BE FURTHER COMMUNICATED**

## Appendix B: Management representation letter

[Please insert NYPACC Letterhead]

PricewaterhouseCoopers  
5700 Yonge Street Suite 1900  
Toronto, Ontario M2M 4K7

May XX, 2011

We are providing this letter in connection with your audit of the financial statements of North York Performing Arts Centre Corporation (operating as the Toronto Centre for the Arts or the Centre) as of December 31, 2010 and for the years then ended for the purpose of expressing an opinion as to whether such financial statements present fairly, in all material respects, the financial position, the results of operations and the cash flows of the Centre in accordance with Canadian generally accepted accounting principles.

**Management's responsibilities**

We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated November 1, 2010. In particular, we confirm to you that:

- We are responsible for the preparation and fair presentation of the financial statements in accordance with Canadian generally accepted accounting principles;
- We are responsible for designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. In this regard, we are responsible for establishing policies and procedures that pertain to the maintenance of accounting systems and records, the authorization of receipts and disbursements, the safeguarding of assets and for reporting financial information in accordance with Canadian generally accepted accounting principles;
- We have provided you with all relevant information and access, as agreed in the terms of the audit engagement; and
- All transactions have been recorded in the accounting records and are reflected in the financial statements.

We confirm<sup>1</sup> the following representations:

**Preparation of financial statements**

The financial statements include all disclosures necessary for fair presentation in accordance with Canadian generally accepted accounting principles and disclosures otherwise required to be included therein by the laws and regulations to which the Centre is subject.

We have appropriately reconciled our books and records (e.g. general ledger accounts) underlying the financial statements to their related supporting information (e.g. sub ledger or third party data). All related reconciling items considered to be material were identified and included on the reconciliations and were appropriately adjusted in the financial statements. There were no material unreconciled differences or material general ledger suspense account items that should have been adjusted or reclassified to another account balance. There were no material general ledger suspense account items written off to a balance sheet account, which should have been written off to a profit and loss account and vice versa. All intracompany and intercompany accounts have been eliminated or appropriately measured and considered for disclosure in the financial statements.

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### **Accounting policies**

We confirm that we have reviewed the Centre's accounting policies and, having regard to the possible alternative policies, our selection and application of accounting policies and estimation techniques used for the preparation and presentation of the financial statements is appropriate in the Centre's particular circumstances to present fairly in all material respects its financial position, results of operations and cash flows in accordance with Canadian generally accepted accounting principles.

### **Internal controls over financial reporting**

We have designed disclosure controls and procedures to provide reasonable assurance that material information relating to the Centre, is made known to us by others.

We have designed internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles.

We have disclosed to you all deficiencies in the design or operation of disclosure controls and procedures and internal control over financial reporting that we are aware as of December 31, 2010.

### **Disclosure of information**

We have provided you with:

- Access to all information of which we are aware that is relevant to the preparation of the financial statements, such as records, documentation and other matters including:
  - Contracts and related data;
  - Information regarding significant transactions and arrangements that are outside of the normal course of business;
  - Minutes of the meetings of shareholders, management, directors and committees of directors. The most recent meeting of the Board was held on March 11, 2011;
- Additional information that you have requested from us for the purpose of the audit; and
- Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

### **Completeness of transactions**

All contractual arrangements entered into by the Centre with third parties have been properly reflected in the accounting records or/and, where material (or potentially material) to the financial statements, have been disclosed to you. We have complied with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance.

### **Fraud**

We have disclosed to you:

- The results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud;
- All information in relation to fraud or suspected fraud of which we are aware affecting the Centre involving management, employees who have significant roles in internal control or others where the fraud could have a material effect on the financial statements; and
- All information in relation to any allegations of fraud, or suspected fraud, affecting the Centre's financial statements, communicated by employees, former employees, analysts, regulators or others.

### **Compliance with laws and regulations**

We have disclosed to you all aspects of laws, regulations and contractual agreements that may affect the financial statements, including actual or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.

We are not aware of any illegal or possibly illegal acts committed by the Centre's directors, officers or employees acting on the Centre's behalf.

### **Accounting estimates and fair value measurements**

Significant assumptions used by the Centre in making accounting estimates, including fair value accounting estimates, are reasonable.

For recorded or disclosed amounts in the financial statements that incorporate fair value measurements, we confirm that:

- the measurement methods are appropriate and consistently applied;
- the significant assumptions used in determining fair value measurements represent our best estimates, are reasonable and have been consistently applied;
- no subsequent event requires adjustment to the accounting estimates and disclosures included in the financial statements; and
- the significant assumptions used in determining fair value measurements are consistent with the Centre's planned courses of action. We have no plans or intentions that have not been disclosed to you, which may materially affect the recorded or disclosed fair values of assets or liabilities.

Significant estimates and measurement uncertainties known to management that are required to be disclosed in accordance with Canadian Institute of Chartered Accountants (CICA) Handbook Section 1508, Measurement Uncertainty and CICA Handbook Section 3862, Financial Instruments – Disclosures, have been appropriately disclosed.

### **Related parties**

We confirm the completeness of information provided to you regarding the identification of related parties as defined by CICA Handbook Section 3840, Related Party Transactions, which include, but are not limited to directors, officers, senior members of management, or immediate family members of such individuals, or entities over which these individuals are able to exert significant influence. We also confirm the completeness of information provided to you regarding the nature of the Centre's relationships with and transactions involving those entities.

The identity and relationship of and balances and transactions with related parties have been properly recorded and adequately disclosed in the financial statements, as required by Canadian generally accepted accounting principles.

The list of related parties attached to this letter as Appendix A accurately and completely describes the Centre's related parties and the relationships with such parties.

All balances and transactions with the City of Toronto have been accurately and completely reflected in the financial statements.

### **Going concern**

We have no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements (e.g. to dispose of the business or to cease operations).

### **Assets and liabilities**

We have satisfactory title or control over all assets. All liens or encumbrances on the Centre's assets and assets pledged as collateral, to the extent material, have been disclosed in the financial statements.

Receivables recorded in the financial statements represent bona fide claims against debtors for sales or other charges arising on or before the statement of financial position date and are not subject to discount except for normal cash discounts. Receivables classified as current do not include any material

amounts that are collectible after one year. All receivables have been appropriately reduced to their estimated net realizable value.

We have recorded or disclosed, as appropriate, all liabilities, in accordance with Canadian generally accepted accounting principles. All liabilities and contingencies, including those associated with guarantees, whether written or oral, under which the Centre is contingently liable in accordance with Accounting Guideline 14, *Disclosure of Guarantees*, or CICA Handbook Section 3290, *Contingencies*, have been disclosed to you and are appropriately reflected in the financial statements.

### **Litigation and claims**

All known actual or possible litigation and claims, which existed at the statement of financial position date or exist now, have been disclosed to you and accounted for and disclosed in accordance with Canadian generally accepted accounting principles, whether or not they have been discussed with legal counsel.

### **Misstatements detected during the audit**

Certain representations in this letter are described as being limited to those matters that are material. Items are also considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

The effects of the uncorrected misstatements in the financial statements, as summarized in the accompanying schedule (Appendix B), are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. We confirm that we are not aware of any uncorrected misstatements other than those included in Appendix B.

The adjusted misstatements identified during your audit and summarized in the attached table (Appendix C) have been approved by us and adjusted in the financial statements.

### **Events after balance sheet date**

We have identified all events that occurred between the statement of financial position date and the date of this letter that may require adjustment of, or disclosure in, the financial statements, and have effected such adjustment or disclosure.

### **Cash and banks**

The books and records properly reflect and record all transactions affecting cash funds, bank accounts and bank indebtedness of the Centre.

All cash balances are under the control of the Centre, free from assignment or other charges, and unrestricted as to use, except as disclosed to you.

The amount shown for cash on hand or in bank accounts excludes trust or other amounts which are not the property of the Centre.

Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, line of credit, or similar arrangements have been properly disclosed.

All cash and bank accounts and all other properties and assets of the Centre of which we are aware are included in the financial statements at December 31, 2010.

**Accounts receivable**

All amounts receivable by the Centre were recorded in the books and records.

Amounts receivable amounted to \$149,000 and are considered to be fully collectible.

Amounts receivable that are non-interest bearing and are expected to be received more than a year after initial recognition date have been initially recognized at fair value, using an appropriate discount rate, and subsequently measured at amortized cost.

All receivables were free from hypothecation or assignment as security for advances to the Centre, except as hereunder stated.

The Centre has accounted for and disclosed transfers of receivables (including securitizations) in accordance with the provisions of AcG-12, *Transfers of Receivables*.

**Loans receivable**

We have reviewed loans receivable for impairment, and made appropriate allowances thereon if necessary, in accordance with CICA 3025, *Impaired Loans*. We have measured impaired loans based upon the present value of expected future cash flows discounted at the loan's effective interest. The allowance for loan losses encompasses probable credit losses related to specifically-identified loans as well as probable credit losses inherent in the remainder of the loan portfolio that have been incurred as of December 31, 2010. The allowance does not include an amount for loan losses expected to be incurred subsequent to December 31, 2010.

**Credit risk**

The following information about each class of financial asset, both recognized and unrecognized, has been properly disclosed in the financial statements:

- Amount of the maximum credit risk exposure without regard to collateral; and
- Significant concentrations of credit.

**Property, Plant and Equipment**

All charges to property, plant and equipment asset accounts represented the actual cost of additions to property, plant and equipment.

No significant property, plant and equipment additions were charged to repairs and maintenance or other expense accounts.

Book values of property, plant and equipment sold, destroyed, abandoned or otherwise disposed of have been eliminated from the accounts.

Property, plant and equipment assets owned by the Centre are being depreciated on a systematic basis over their estimated useful lives and the provision for depreciation was calculated on a basis consistent with that of the previous date.

All lease agreements covering property leased by or from the Centre have been disclosed to you and classified as capital, operating, sales-type or direct financial leases as appropriate.

Assets held under capital leases are being amortized on a systematic basis over the period of expected use.

There have been no events or changes in circumstances that indicate the carrying value of a long-lived asset is not recoverable; accordingly management was not required to perform an impairment test in accordance with CICA 3063, Impairment of Long-lived Assets during the period. We believe that the carrying amount of the Centre's long-lived assets is fully recoverable.

#### **Accounts Payable**

Amounts payable that are non-interest bearing and are expected to be paid more than a year after initial recognition date have been initially recognized at fair value, using an appropriate discount rate, and subsequently measured at amortized cost.

#### **Long-term debt**

All borrowings and financial obligations of the Centre of which we are aware are included in the financial statements at December 31, 2010, as appropriate. We have fully disclosed to you all borrowing arrangements of which we are aware.

The Centre has appropriately classified as current and non-current loan to the City of Toronto in the Centre's classified statement of financial position as of December 31, 2010 in accordance with the appropriate authoritative guidance. In evaluating the appropriate classification of its borrowings, the Centre considered all relevant facts and circumstances, for example: contractual terms, the existence of call options, subjective acceleration clauses, material adverse changes clauses, lock-box arrangements, covenant violations, renewal features, conversion features, redemption features, and ability and intent to refinance.

#### **Unearned revenue and deferred credits**

All material amounts of unearned revenue and deferred credits including deferred income taxes were appropriately recorded in the books and records.

#### **Commitments**

Provisions have been made for losses to be sustained in the fulfillment of, or from inability to fulfill, any sales commitments.

Provisions have been made for losses to be sustained as a result of purchase commitments for inventory quantities in excess of normal requirements or at prices in excess of prevailing market prices.

#### **Financial Instruments**

The carrying values of the Centre's financial instruments approximate their fair values unless otherwise noted.

The Centre has chosen to apply the Canadian Institute of Chartered Accountants (CICA) Handbook Section 3861, Financial Instruments – Disclosure and Presentation, in place of Section 3862, Financial Instruments – Disclosures, and Section 3863, Financial Instruments – Presentation.

#### **Revenue Recognition**

The conditions, including reasonably dependable estimates, for use of percentage-of-completion accounting under generally accepted accounting principles are present.

We have reviewed the criteria for revenue recognition included in CICA 3400, *Revenue*, and EIC 141, *Revenue Recognition*, and EIC 123, *Reporting Revenue Gross as a Principal vs. Net as an Agent*, namely, evidence of arrangement, delivery, fixed price and collectibility and are recognizing revenue in accordance with these standards.

We have fully disclosed to you all sales terms (whether written or oral), including all customer-acceptance provisions, rights of return or price adjustments, and all warranty provisions.

We did not issue any side letters in regards to our sales agreements.

**Art Collection**

The art collection recorded in the financial statements is property of the Centre. Amounts reflected have been accurately and completely recorded.

Yours truly,

**North York Performing Arts Centre Corporation  
(operating as the Toronto Centre for the Arts or the Centre)**

---

Pim Schotanus, General Manager

**Appendix A** – List of related parties

City of Toronto

**Appendix B – Summary of Uncorrected Misstatements (SUM)**

Description	Excess of revenue over expense	Statement of financial position		
		Assets (over) under stated	Liabilities over (under) stated	Net assets over (under) stated
To adjust a deferred amount to revenue from operations	(6,309)	-	6,309	-
<b>Total unadjusted differences</b>	<b>(6,309)</b>	<b>-</b>	<b>6,309</b>	<b>-</b>

**Appendix C – Summary of Adjusted Misstatements (SAM)**

Description	Excess of revenue over expense	Statement of financial position		
		Assets (over) under stated	Liabilities over (under) stated	Net assets over (under) stated
To net the HST receivables and payables at year end.	-	(25,394)	25,394	-
To reclassify cash to cash held in-trust	-	(34,340) 34,340	-	-
To adjust withdrawal from stabilization reserve fund as a reduction of fund balances	(49,232)	-	-	49,232
To recognize rebates on Dancap sales on a net basis	127,287 (127,287)			
<b>Total adjusted differences</b>	<b>49,232</b>	<b>(25,394)</b>	<b>25,394</b>	<b>49,232</b>

## Appendix C: Independence letter

April 21, 2011

Members of the Audit Committee  
The North York Performing Arts Centre Corporation  
(operating as Toronto Centre for the Arts)

To the Members of the Audit Committee,

We have been engaged to audit the financial statements of North York Performing Arts Centre Corporation (operating as the Toronto Centre for the Arts, referred to here as the Centre) for the year ended December 31, 2010.

Canadian generally accepted auditing standards (GAAS) require that we communicate at least annually with you regarding all relationships between the Centre, its management and us that may reasonably be thought to bear on our independence.

In determining which relationships to report, these standards require us to consider relevant rules and related interpretations prescribed by the Institute of Chartered Accountants of Ontario and applicable legislation, covering such matters as:

- (a) holding a financial interest, either directly or indirectly, in a client;
- (b) serving as an officer or director of a client;
- (c) performance of management functions for an assurance client;
- (d) personal or business relationships of immediate family, close relatives, partners or retired partners, either directly or indirectly, with a client or its management;
- (e) economic dependence on a client;
- (f) long association of senior personnel with a listed entity audit client;
- (g) audit committee approval of services to a listed entity audit client; and
- (h) provision of services in addition to the audit engagement.

We have prepared the following comments to facilitate our discussion with you regarding independence matters.

We are not aware of any relationships between the Centre or its management and PricewaterhouseCoopers LLP that may reasonably be thought to bear on our independence, that have occurred from November 1, 2010, date of our engagement letter with the City of Toronto, which refers to the services we provide to the Centre, to April 21, 2011.



We hereby confirm that we are independent with respect to the Centre within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario as of April 21, 2011.

This report is intended solely for the use of the audit committee, the board of directors, management, and others within the Centre and should not be used for any other purposes.

We look forward to discussing with you the matters addressed in this letter at our upcoming meeting on May 2, 2011.

Yours very truly,

*PricewaterhouseCoopers LLP*

Chartered Accountants, Licensed Public Accountants

## Appendix D: Changes in financial reporting requirements for Canada's not-for-profit organizations

# *Keeping you informed*

Changes in financial reporting requirements for Canada's not-for-profit organizations



## Changes in financial reporting requirements for Canada's not-for-profit organizations

In December 2010, the Canadian Accounting Standards Board issued new accounting standards for not-for-profit organizations (NPOs) and changes for government not-for-profit organizations (GNPOs).

Under the previous approach, both GNPOs and non-government NPOs were directed to follow the Canadian Institute of Chartered Accountants' (CICA) Handbook, which includes standards developed to deal with the unique circumstances of many NPOs — the 4400 series. The new accounting framework will now be dependent on your organization's classification as either an NPO or GNPO.

To determine which standards to follow under the new framework, it's

important to understand whether or not your organization is controlled by a government body. The Public Sector Accounting (PSA) Handbook section 1300 provides guidance on the interpretation and application of the concept of government control. In some instances it may not be readily apparent whether government control exists, especially when an organization receives government funding indirectly or from a number of government bodies. As a result, NPOs should have a careful understanding of their particular facts and circumstances.

Once you've determined whether your organization is a government or non-government NPO, you will be required to adopt the appropriate standards for fiscal years beginning on or after January 1, 2012. The standards may have a significant impact on the financial reporting for your organization. We encourage both NPOs and GNPOs to consider the potential impact of the new standard and the appropriate time frame for adoption, as early adoption is permitted.



## Understanding the new framework

The following table summarizes the key distinction in the new framework:

Definition	Existing Canadian Generally Accepted Accounting Principles (GAAP)	New Canadian Generally Accepted Accounting Principles
Non-government not-for-profit organizations Organizations that are not controlled by the government and that are organized and operated exclusively for social, educational, professional, religious, charitable or any other NPO purposes. Its members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization.	Former CICA Handbook, including CICA 4400 Series (standards that apply only to NPOs)	Choice between: a. Part I of the CICA Handbook – International Financial Reporting Standards (IFRS) b. Part III of the CICA Handbook – Accounting Standards for Not-For-Profit Organizations (based largely upon Part II of the CICA Handbook – Accounting Standards for Private Entities, plus CICA 4400 Series)
Government not-for-profit organizations Organizations controlled by the government that have counterparts outside the public sector and that are organized and operated exclusively for social, educational, professional, religious, charitable or any other NPO purposes. Its members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization. Under the current definition, schools, hospitals, colleges and universities typically fall under this category.	Former CICA Handbook, including CICA 4400 Series	Choice between: a. PSA Handbook b. PSA Handbook supplemented by CICA 4400 series for NPOs which have been incorporated into the PSA Handbook as PS4200

## Potential impacts of adopting Part III of the CICA Handbook – Accounting Standards for Not-For-Profit Organizations

It is expected that the majority of non-government NPOs in Canada will adopt Part III of the CICA Handbook. While for many organizations, this will not result in any significant accounting or disclosure changes, for others the implications may be more significant. The potential accounting and disclosure differences for NPOs that elect to adopt Part III of the Handbook include:

### Accounting

- **Intangible assets** – A new intangible assets section reaffirms the applicability of section 3064 Goodwill and intangible assets, unless provided otherwise in the new section. Organizations are directed to consider the service potential of an intangible asset when assessing the existence of an impairment.
- **Financial instruments.**
  - The disappearance of the “available for sale” option means that organizations will no longer have the option to recognize unrealized gains and losses in the statement of changes in net assets/fund balances. Going forward, all changes in the fair value of the financial instruments will be recognized in the statement of operations.
  - All financial instruments can be carried at fair value if the option is selected on initial recognition. If not, the default treatment for quoted debt securities will be cost or amortized cost. For quoted equity securities, it will continue to be fair value. This creates a different default accounting treatment for investments depending on their nature.

- **Transaction costs** – Transaction costs incurred to acquire or issue financial instruments measured at amortized cost will be required to be netted against the carrying value rather than being expensed.
- **Defined benefit plans** – For organizations with a defined benefit plan, there will be an option to select between the “immediate recognition approach”, where actuarial gains or losses would be recognized immediately in the statement of operations each period, or the “deferral and amortization approach”.
- **Capital assets** – On transition to these standards, the organization may measure any individual capital asset at fair value and then use that fair value as its deemed cost at that date.
- **Government remittances** – Government remittances payable that are outstanding at the balance sheet date are required to be disclosed and include federal and provincial sales tax, payroll taxes, health taxes and workers’ safety insurance premiums among other items.
- **Measurement uncertainty** – A description of the circumstances giving rise to the uncertainty and relevant information about the anticipated resolution of the uncertainty is required. Previously only the nature of material uncertainties was required to be disclosed.
- **Presentation of investments** – Investments are classified as current only when reasonably prompt liquidation is possible.

#### Presentation and disclosure

- **Primary Generally Accepted Accounting Principles** – Various items have been eliminated from the primary principles including Emerging Issues Committee (EIC) abstracts, background information, basis of conclusion documents, illustrative material and implementation guides.
- **Cash flow statements** – All organizations must prepare and present a cash flow statement. There is no longer the option to omit the cash flow statement if the required cash flow information is readily apparent from other financial statements or note disclosures.
- **Non-classified balance sheet** – The balance sheet is segregated into current or non-current categories unless the entity operates in an industry where doing so is not appropriate.
- **Capital disclosures** – The requirement to disclose the organization’s policy and capital restrictions has been eliminated.
- **Inventory** – No significant changes other than a reduction in disclosures – for example, there is no longer the requirement to have specific disclosures around impairments or reversals.

### ***Potential impacts of adopting Part I of the CICA Handbook – International Financial Reporting Standards***

The option to adopt International Financial Reporting Standards (IFRS) is available to all non-government NPOs but will likely initially only be considered by those organizations that:

- Are part of a global organization whose affiliates have chosen to use IFRS;
- Participate in an industry with for-profit companies who report under IFRS; or
- Have international funders or other users of the financial statements who require the use of IFRS.

IFRS was originally developed for use in the for-profit world and does not contain specific guidance for NPOs. In addition, there is currently no intention to modify IFRS for NPOs; these organizations will be subject to the same standards and requirements as publicly accountable entities. Some of the most significant accounting and reporting implications of adopting IFRS include:

### ***Accounting***

- **Revenue recognition** – Under IFRS, there are no specific standards to address the unique nature of contribution revenue for NPOs. This specifically impacts the recognition of contributions restricted for specific purposes or time periods as well as endowment contributions that currently have specific recognition criteria under Canadian Generally Accepted Accounting Principles. Under IFRS, revenue is recognized under a general revenue recognition standard that may result in timing differences for recognition of contributions.
- **Property and equipment** – IFRS permits an entity to revalue property and equipment to fair value on the date of transition to the new accounting framework. If a NPO has investment property, it must be carried at fair value and revalued annually to determine any fair value adjustments. Annual assessments for impairment of property and equipment must be made and impairment losses recovering in future periods can be reversed and recorded in the financial records.
- **Consolidation** – Current Canadian accounting standards provide NPOs with various alternatives to report controlled and related entities. Under IFRS, no similar standard exists, so accounting for controlled and related entities would follow general consolidation standards. This would result in the consolidation of all controlled entities and equity accounting for all entities in which a NPO has significant influence. Cost accounting would be used for those investments that a NPO does not control or have significant influence.

- **Employee future benefits** – While the standards around employee future benefits are similar to current Canadian GAAP, there are some differences that could result in how employee future benefits are recognized under IFRS. These primarily relate to the immediate recognition of past service costs and the planned elimination of the ability to smooth the recognition of actuarial gains and losses over time periods.
- **Capital leases** – Under current IFRS standards, accounting for leases is similar to Canadian GAAP. However, the specific tests to determine if a lease is capital in nature are slightly different, which may result in a different conclusion under IFRS. Organizations should also be aware that there is a current IFRS exposure draft on leases that could significantly change how leases are accounted for, including the potential recognition of all leases, operating and capital, on the balance sheet.
- **Financial statement notes** – Under IFRS, note disclosure is generally more extensive, with detailed note requirements for specific accounts and balances. For example, disclosure of the compensation of key management personnel is required under IFRS in the notes to the financial statements. As well, because many NPOs have previously taken advantage of the exemptions available under Canadian GAAP to limit disclosures around financial instruments, additional disclosures will likely be required in this area.
- **Financial Instruments** – There are currently no standards dealing with financial instruments, although draft standards are currently under review. If adopted in their current form, there would be several changes, including the requirement to recognize unrealized gains and losses associated with derivatives and the translation of foreign denominated balances in a statement of remeasurement gains and losses.

### Presentation and disclosure

- If an organization elects to adopt the PSA Handbook excluding sections 4200 to 4270, there will be numerous differences in presentation with respect to the primary statements. For example, statement of financial position classifications will now include financial and non-financial assets. The statement of operations will include budget information, and a statement of changes in net debt will be required. However, if an NPO elects to adopt the PSA Handbook including the 4200 series of standards, financial statement presentation will be largely unchanged.

Organizations converting to the PSA Handbook will need to identify the differences in the standards that impact them and quantify these differences. In addition, the PSA Handbook contains specific exemptions and exceptions applicable to the first time adoption of PSA Standards by government organizations.

### Potential impacts of adopting the PSA Handbook

The status quo will no longer be an option for GNPOs as the PSA Handbook guidance differs from the CICA Handbook. Some of the more significant differences include:

#### Accounting

- **Pension plans** – Neither the corridor approach nor full recognition of actuarial gains and losses are allowed – all actuarial gains and losses are amortized over the average remaining service life of the employee group. There are other changes in the calculation methodology including the discount rate and a requirement to recognize plan amendments immediately.
- **Other employee future benefits** – Leave benefits, such as sick pay, are accrued under the PSA Handbook regardless of vesting provisions.
- **Intangibles** – Other than software, intangibles are not recognized as assets. Goodwill is rarely capitalized, but rather expensed in the period of acquisition.

### Presentation and disclosure

- **General financial statement presentation and fund accounting** – IFRS does not have an equivalent standard to Handbook Series 4400. As a result, the concept of fund accounting and the presentation of separate funds in the financial statements does not exist under IFRS. Related statements, such as the statement of changes in net assets, are replaced with IFRS statements, and would include a statement of comprehensive income.

# Next steps

Organizations are required to transition to the appropriate standards by the fiscal year beginning on or after January 1, 2012, although early adoption is permitted. Now is the time to consider the options available and start to think about the appropriate implementation date of the new standards for your organization. Our team understands the new framework and is ready to help you through the process.

## Contact us

### British Columbia

Ken Legg  
604 806 7579  
ken.legg@ca.pwc.com

### Toronto

Sara Oates  
416 228 1104  
sara.oates@ca.pwc.com

### Alberta

Julie Thomson  
403 509 7551  
julie.d.thomson@ca.pwc.com

### Ottawa

Adam Harvey  
613 755 8711  
adam.e.harvey@ca.pwc.com

### Saskatchewan

Dean Staff  
306 668 5954  
dean.staff@ca.pwc.com

### Atlantic

Stephanie Maritz  
902 491 7427  
stephanie.maritz@ca.pwc.com

### Manitoba

Kim Nykoluk  
204 926 2437  
kim.a.nykoluk@ca.pwc.com



## Appendix E: Financial reporting release

Financial Reporting Release

# Keeping your head above water...

Recent issues in financial reporting

January 2011



# In this Issue

It will come as no surprise that this issue of *Financial Reporting Release* is all about International Financial Reporting Standards. How could it not? With Canadian publicly accountable enterprises on the cusp of adopting IFRS and existing Canadian GAAP frozen in anticipation of the changeover, 2010 year end statements are ho-hum. What's really causing all the excitement in town these days is first-time 2011 IFRS reporting.

And so let us start this edition with the welcome news that the final piece in Canada's IFRS reporting puzzle has been put into place. In the last quarter of 2010, Canadian Securities Administrators published their IFRS-related amendments to Canadian securities reporting rules. Are you going to have to make last minute fixes to your IFRS accounting as a result? Do you have more reporting options than you did before? We have some thoughts.

Not everybody's excited about 2011 IFRS reporting. Canadian rate-regulated enterprises and investment companies got a reprieve from this reporting from the Accounting Standards Board in Canada. They are now required to adopt IFRS only in 2012. The stories behind the deferrals are specific to these sectors but they also reveal a broader truth about global standard-setting which we would all do well to remember: sometimes it can move very slowly; indeed, sometimes not at all.

But don't infer from the above that life in IFRS land has come to a complete standstill since our last visit. While no blockbuster standards were issued, and only one exposure draft of any consequence (on hedging), there have been some developments that might affect 2011 transition reporting. Hint: if you own real estate or other investment properties, or have commercial paper outstanding, you might want to pay close attention. Really close.

As you know, our usual practice is to report only recent accounting developments but in this edition we've made an exception. Seeing as how everyone's focusing on IFRS transition, we've also snuck in an important reminder – whatever you do, make sure that you've nailed down the implications of IFRS on your debt covenants. The credit standing you wind up saving could be your own.

These days no issue of *Financial Reporting Release* would be complete without an update on the ambitious plans of the IASB and FASB (collectively, "the Boards") to converge their respective standards. The saga continues. Late in the year, the Boards announced radical surgery to their plans, abandoning some projects, at least for the moment, and ramping up others. Wondering where your favourite project fits? Read on, dear reader, read on.

And there you have it. Everything you need to know about IFRS developments affecting your transition and life beyond. Does it get any better than this?

- 2** Transitioning to IFRS
- 3** Rate-regulated Accounting
- 4** Investment Companies
- 5** Recent IFRS Developments Affecting Transition
- 6** Debt Covenants under IFRS
- 7** Global GAAP Convergence
- 8** Financial Instruments
- 9** Hedge Accounting
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# Transitioning to IFRS

**“Change is inevitable – except from a vending machine” – C. Gallagher**

For all Canadian publicly accountable enterprises (well almost all, as we'll see in a few minutes) the priority for 2011 will be to get over the IFRS transition hump – negotiating the changeover from existing Canadian GAAP to IFRS in first quarter 2011 interim financial statements all in one piece.

There were some developments late in 2010 that will affect your transition. In October, the CSA released their long-awaited IFRS amendments to Canadian securities reporting requirements. There are no real surprises when it comes to first-time IFRS interim financial statements. Consistent with the CSA's draft proposals, the final amendments require inclusion of a supplementary IFRS balance sheet as at the effective date of your transition to IFRS (January 1, 2010 for most companies), and an explicit affirmation in your disclosures that the statements are in compliance with IFRS interim reporting requirements.

The CSA's IFRS amendments include revised guidance on the use of performance measures, such as EBITDA, in an IFRS reporting environment. That guidance is similar in many respects to existing requirements, but with a few twists. For example, it doesn't outright ban the

use of EBITDA and other performance measures in financial statements not explicitly contemplated by IFRS. Don't cheer too loudly, EBITDA lovers. The criteria for applying these measures are strict.

You should also know that in late November 2010, the Ontario Securities Commission released a “top ten” summary of IFRS transition reminders and advice which provides a convenient basis for assessing how your IFRS transition reporting stacks up against regulatory expectations. This includes disclosure about IFRS transition in your 2010 annual MD&A filings. Much of the commentary takes the form of suggestions but, as always with regulators' suggestions, disregarding them could lead to some unwelcome chats down the road.

**PwC Observation.** Listen to your inner voice in deciding how best to comply with requirements for transitioning to IFRS, and communicating the changes to financial statement users. Rigid reliance on rote, “check the box”, or copycat approaches usually will result in a clutter of irrelevant information that will only obscure, confuse and distract the reader. Just because somebody else did it one way doesn't mean you should too – or that it's good enough for you.

# Rate-regulated Accounting

**“The difference between depression and disappointment is your level of commitment”**

– Marc Maron

The following is a cautionary tale about the ups and downs of the global standard-setting process and its effect on domestic financial reporting. The subject is rate-regulated accounting (“RRA”) but that doesn’t really matter. It could be anybody’s accounting.

Our story begins a few years ago, when Canadian rate-regulated enterprises (“RREs”) preparing for transition to IFRS began to fuss about whether RRA could survive under IFRS. RRA involves setting up assets or liabilities for future charges or refunds to customers instead of treating them as adjustments of revenue when they happen. Unlike existing Canadian and US GAAP, IFRS doesn’t explicitly sanction this basis of accounting. As a result of concern over this, Canada asked the IASB to provide guidance on the issue. And so in 2009, the IASB issued an exposure draft which allowed RRA in qualifying circumstances. The exposure draft enjoyed broad support from North American constituents but drew significant opposition from many other parts of the world. In July 2010, the IASB postponed making a final decision, deciding more research and deliberation was necessary.

Given the prospect of delay, the AcSB proposed a two-year deferral from adopting IFRS for RREs. The thinking was that this would allow the IASB sufficient time to finish the project and provide certainty to Canadian RREs on how IFRS applies. Alas, after further considering its own priorities (more about those later) and other factors, the IASB abruptly withdrew RRA from its agenda shortly thereafter. In the circumstances, the AcSB and the CSA deemed it only fair to give affected Canadian RREs more time to ponder the appropriateness of RRA under existing IFRS. As a result, RREs and companies that consolidate RREs now have until years starting on or after January 1, 2012 to effect the changeover.

**PwC Observation.** In the end, the IASB’s RRA project had much in common with a Greek tragedy – it’s hard to walk away feeling other than depressed or disappointed. The IASB has made some vague noises about perhaps resurrecting the project at some later date in perhaps a different form, but there’s no prospect of this happening anytime soon.

# Investment Companies

**“By trying we can easily endure adversity. Another man’s, I mean.” – Mark Twain**

You’re probably familiar with at least parts of this story. As we’ve discussed in previous issues of the *Financial Reporting Release*, existing Canadian GAAP precludes an investment company from consolidating investments it might happen to control in all but remote circumstances. Existing IFRS, however, always requires consolidation. IFRS reporting thus is a significant issue for IFRS-bound Canadian investment companies, all of which are adamant that consolidation doesn’t provide sufficient meaningful information in a world where the overriding concern of investors is fair value.

Relief is supposed to be on the way. As part of its convergence efforts with the FASB, the IASB has a project on its agenda to exempt investment companies from consolidation. In anticipation, in September the AcSB deferred mandatory adoption of IFRS for investment companies until years starting on or after January 1, 2012 (segregated accounts of life insurance enterprises get the same break for the same reasons). The CSA also has provided relief for investment funds. Beware. If you’re not an investment company, but are consolidating one, there is no relief. You’re stuck with consolidating the investments controlled by these entities on transition to IFRS in 2011.

Implicit in the AcSB’s deferral, of course, is the assumption that the IASB will issue their consolidation exemption in time for adoption by Canadian investment companies in their 2012 reporting. Ominously perhaps, the IASB announced in November 2010 that it no longer considered the project to be a top priority (we explain why later). The aim now is to complete the project by the end of 2011 though the IASB hasn’t committed to this timing in its official work plan. As you might imagine, this has caused a collective gulp in the Canadian investment company community. Still, there’s nothing more that can be done now other than...endure.

**PwC Observation.** While some might see disturbing parallels between the investment company project and rate-regulated accounting, there’s one important difference. IASB staff outreach on the project revealed unanimous support for investment company consolidation relief from investor user groups, everywhere. We’re hopeful the IASB will complete the project in 2011. Nevertheless, the timing is a worry. Further transition relief from the AcSB may be necessary. We expect the AcSB would give this every consideration.

# Recent IFRS Developments Affecting Transition

**“Tut, tut, child,” said the Duchess. “Everything’s got a moral if only you can find it.”**

– Lewis Carroll, *Alice in Wonderland*

Since our last issue, there have been a few IFRS developments that might affect your transition in 2011. No blockbuster new standards, mind you, but the changes still might wallop your financial statements. Here are some of the more important ones.

## **Classification by the borrower of commercial paper and other similar debt**

In early January 2011, the IFRS Interpretations Committee considered the issue of balance sheet classification of commercial paper and other short-term debt obligations backed by long-term loan facilities. The IFRIC agreed that under existing IFRS these debts should be classified as current liabilities when the facility is with a different lender. If the facility is from the same lender, long-term classification is appropriate in some circumstances. The Committee will recommend that the IASB clarify the applicable IFRS requirements as part of their annual improvements project.

## **Income taxes – investment properties**

Late in 2010, the IASB amended its income tax standard in order to simplify the calculation of deferred taxes for investment properties elected to measure at fair value under IFRS. What are investment properties? Think of things like office buildings and other income-producing properties in the real estate industry. Under the amendment, you would set up deferred income taxes at the tax you’d expect to pay assuming you sold the property for its fair value at the balance sheet date. The rule applies even if you don’t intend to sell – with one exception. If your business plan is to hold and operate the asset for its remaining useful life (and we mean all of the remaining life), then you would set up taxes assuming this course of action. In some jurisdictions, calculating deferred taxes on the basis a property will be sold rather than held and operated can result in significantly different deferred taxes because the tax consequences of the two alternatives aren’t always the same. For example, when the fair value of a property is

in excess of its cost, presuming a sale might result in taxes being set up using the capital gains rather than the ordinary business rate. The amendment is effective for annual periods beginning on or after January 1, 2012 but you can adopt it earlier if you like, including at transition.

## **IFRS transition rules**

The IASB made a few last minute changes to IFRS transition rules. From a Canadian perspective, perhaps the most significant one relates to the date for determining when you have to apply the IFRS derecognition requirements. Previously, you had to consider all transactions occurring on or after January 1, 2004. Now, you will have to consider transactions occurring only after the date of transition. The change is effective for years beginning on or after July 1, 2011 but earlier application is permitted. This gives you the opportunity to reconsider your transition accounting for things like securitizations of receivables that qualify as sales under existing Canadian GAAP, but are financings under IFRS (subject to any regulatory approval you might require).

## **Other**

The IASB amended its financial instrument rules for financial liabilities elected by the entity for measurement at fair value through profit and loss. Now, changes attributable to credit risk go to OCI instead. Also, derecognition and interim disclosures have been beefed up.

**PwC Observation.** Consider the effects of these changes with care. For example, setting up deferred income taxes with the expectation that you’re going to sell an investment property at the balance sheet date might lead to some pretty wonky looking income tax expenses if you’re still holding the property when you run out of tax shelter. The moral here? Not everything might be as it seems.

# IFRS Transition and Debt Covenants

**“Running into debt isn’t so bad, it’s running into creditors that hurts.” – Unknown**

Over the holidays, you may have noticed a bit in the business section about the impact of moving over to IFRS on companies’ credit ratings. The gist was that changing over shouldn’t ordinarily affect ratings because IFRS is only a different way of communicating financial information and doesn’t affect a company’s fundamentals. This is true, but don’t get too comfortable. Changing over to IFRS could affect your technical compliance with financial debt covenants. And that, of course, could affect your credit standing.

Everybody and their mothers know by now that transitioning to IFRS can result in significant differences in the recognition, measurement and classification of assets and liabilities relative to existing Canadian GAAP. It would be nice to provide general guidance on the implications of those differences for debt covenant calculations, but it’s just not possible. And that’s because there’s no standard wording for covenants. In some cases, for instance, you have to measure compliance using the GAAP in effect when the debt was issued. In others, covenants ask you to incorporate the effects of some or all subsequent changes in GAAP.

Often, covenant calculations include special non-GAAP adjustments. How a changeover from existing Canadian GAAP to IFRS fits into the overall picture will very much depend on the terms of each agreement.

In considering debt covenants, we do have one general thought. You might think you’re moving over to a different GAAP when you move over to IFRS, and you are, but remember, IFRS technically still qualifies as “Canadian GAAP”. In the brave new world of financial reporting in Canada, the term “Canadian GAAP” has become a kind of overarching label that accommodates, at last count, five separate and distinct basis of financial reporting: Existing Canadian GAAP, IFRS, Private Enterprise GAAP, Not-for-Profit Organizations, and Pensions Plans. Which of these do your covenants require you to apply?

**PwC Observation.** Assessing the impact of IFRS on debt covenants is sort of like cutting wood – better measure twice before starting to saw.

# Global GAAP Convergence

**“Everybody has a plan until they’re punched in the face” – Mike Tyson**

We know. We know. You’re tired of hearing about global GAAP convergence. We’ll keep it short.

What’s new is that late in 2010, the Boards suspended work on four projects: financial statement presentation, distinguishing debt from equity, emissions trading schemes, and, less significantly for everyone other than those with a dangerously misplaced interest in all things accounting, the reporting entity phase of the conceptual framework.

The Boards are pulling the plug on these undertakings, temporarily, because they need more time to finish other convergence projects that have a higher priority and are subject to their self-imposed deadline of June 30, 2011 (see Table on right). The IASB has also stopped or slowed down work on other projects, including provisions and contingencies, income taxes, annual IFRS improvements, and as we have already seen, rate-regulated accounting and consolidation by investment companies. They’ve also decided to defer release of their new joint ventures standard until new consolidation rules come out.

The Boards issued a consultative document asking constituents’ views on when and how the new standards should be mandatorily effective. We expect this will be 2013 at the earliest.

**PwC Observation.** In the past, the Boards have given a variety of reasons for their mid-2011 timing: G20 pressure for common global accounting standards, the impending retirement of the Chair of the IASB, the SEC 2011 decision whether to adopt IFRS for US reporting purposes, and to help countries that are moving over to IFRS in 2011 avoid

double switches in accounting. The downside to the Boards’ timing, of course, is the risk that this will compromise due process and the quality of standards. The Boards swear this won’t happen but it hasn’t stopped some from expressing concerns that perhaps the Boards are moving too fast.

IASB Convergence Projects Still Standing	
Project	Primary Objective
Financial instruments (Q2)	Um, well, uh ... see the next page.
Fair value measurement (Q1)	Tweaking guidance on the largely philosophical question of what fair value is, and the largely practical question of how to measure it.
Revenue recognition (Q2)	Reducing the plethora of revenue recognition models out there to a single basic one that everybody has to follow.
Leases (Q2)	Killing off-balance sheet accounting for operating leases.
Presentation of OCI (Q1)	Improving, if not entirely demystifying, the reporting of that beast called other comprehensive income.
Consolidation, other than investment companies (Q1)	Narrowing the gap between IFRS and US GAAP rules, including the rules for SPEs. There will be new disclosures as well.
Insurance contracts (Q2)	Divining an IFRS standard for insurance contracts that the FASB hopefully will also pick up. This project has resisted resolution for years and years and years.
<b>(Q1) or (Q2) = quarter of expected release of standard</b>	

# Financial Instruments

**“There is no problem so big it cannot be run away from.” – Charles Schulz**

It is a truth universally acknowledged that financial instruments are a cornerstone of the Boards convergence strategy. But don't expect fully converged IASB and FASB financial instrument standards to hit your doorstep by the middle of 2011. As we discuss below, the risk is very high that significant differences will remain.

As contemplated by the Boards, convergence of financial instrument standards involves addressing the following main issues:

- Determining which instruments to measure at fair value and whether to report changes in fair value in net income or OCI;
- Setting criteria for recognition of impairment losses on assets carried at amortized cost (including loan portfolios) and how to measure the losses;
- Deciding when to allow hedge accounting and how to apply it (see next page); and
- Establishing rules to offset derivatives and other recognized financial assets and liabilities and to present them net on the balance sheet (this just added to the agenda).

What's the problem in coming up with common solutions? In a nutshell – the Boards have strongly held but differing views as to what improvements to standards are necessary and appropriate. For instance, recent FASB proposals would have many more financial instruments being measured at fair value than under IFRS. Convergence efforts also have been complicated by political pressures. During the financial crisis, the Boards were compelled to undertake improvements to their own standards separately, according to their own timetables, and only then undertake a common effort to produce joint standards (offsetting is an exception).

The Boards have been frank in acknowledging the diversity in their views and other challenges in the process of converging financial instrument standards. So much so that in a recent report on the status of the IASB's progress on financial instruments, the IASB Chair observed that the Boards might have to consider what steps, if any, should be taken to assist investors and other users of financial statements to reconcile unresolved differences, such as through presentation and disclosures.

**PwC Observation.** The Boards aren't running away from the problems; they are just out of time.

# Hedge Accounting

**During the crossing, Einstein explained his theory to me every day, and by the time we arrived I was fully convinced that he really understands it – C. Weismann**

There's no getting around it, existing hedge accounting requirements, both under IFRS and US GAAP, can be tough. Really tough. Listening to a hedge accounting expert explain hedging rules is sort of like hearing your car mechanic explain why your repair bill is so high – for most of us, all you can do is try to look intelligent, nod at what you hope are the appropriate intervals, and then pay up.

The IASB hopes to address this concern. In December 2010, the IASB issued an exposure draft of a revised hedge accounting standard that has simplification as a major objective. Key proposals designed to achieve this are:

- Linking the qualification criteria for hedge accounting more closely to the entity's business risk management strategies;
- Eliminating arbitrary bright line tests as to what constitutes a successful hedge (the dreaded "80-125" correlation test);
- Allowing hedge accounting for more particular risks inherent in non-financial assets; and
- Accumulating changes in fair value of hedged items in a separate balance sheet account rather than posting them to the assets and liabilities to which they relate.

FASB hedging proposals for US GAAP were issued a few months ago. These are not nearly so accommodating. In fact, they contain none of the IASB's simplification proposals. In these respects, anyway, it's pretty much business as usual. It's not a drive down a different path from current requirements.

**PwC Observation.** Hedge accounting changes the timing of recognition of gains and losses in net income from what normally happens under GAAP. For this reason, some accountants think that the criteria for using it have to be very strict. Otherwise, the door would be open for the nefarious to do an end run around regular GAAP. Others believe that relaxing the criteria somewhat is fundamental if management is to be able to properly explain the consequences of the business's risk management strategies. Right now, anyway, it sure looks like the Boards are sitting on opposite sides of this important philosophical divide. Resolving this difference by June 2011 appears unlikely, especially given the timing for completion of the FASB's separate project.

# Life after Convergence

**“In theory there is no difference between theory and practice. In practice there is.” – Yogi Berra**

The IFRS Advisory Council was formed a few years ago to advise the IASB on its work plans and agenda. We thought you might like a peek at the Council’s recommendations to the IASB subsequent to its global GAAP convergence activities with the US.

In summary, the major recommendations are:

- Focus on ensuring that IFRS achieves the objective of requiring high quality financial reporting by being responsive to the needs of those already using IFRS, or who are moving to IFRS.
- Continue to develop standards that meet the needs of investors but monitor and co-ordinate activities with regulators so that financial statements, to the extent possible, can accommodate their needs and objectives, in particular, financial stability.
- Provide a period of calm after convergence is complete and new standards are issued. Be prepared to respond quickly to implementation issues as new standards come into effect.
- Allocate significant resources to ensure that standards are consistently interpreted and applied and that they produce the intended results.

- Update the conceptual framework that underpins standards and develop a disclosure framework.
- Enhance outreach activities. One option may be establishing regional offices.
- Monitor trends and developments in financial reporting, such as XBRL, and develop strategic plans accordingly so as to protect the relevance of the IFRS brand.
- Manage the relationship between IFRS and the special IFRS standards for small and medium enterprises (“SMEs”) to avoid confusion in the market. Update IFRS for SMEs as appropriate.

**PwC Observation.** We expect that many Canadian companies would firmly support many of these proposals. In particular, the absence of mechanisms in IFRS to address emerging issues effectively on a timely basis has been a common concern. Providing extensive interpretation and application guidance got a bad name during the financial crisis because of the worry that this was aiding and abetting financial statement engineering. Popular opinion, in Canada anyway, seems to be that a happy balance has yet to be struck. While the theory that everyone should use professional judgment to come up with the one answer that’s particularly appropriate in their circumstances sounds good, it’s creating significant discomfort in practice.

# For more information ...

This newsletter has been prepared for the clients and friends of PricewaterhouseCoopers by National Accounting and Assurance. For further information on any of the matters discussed, please feel free to contact any member of NAA, or your PwC engagement leader. This newsletter is available from the PwC Canada web site, which is located at [www.pwc.com/ca](http://www.pwc.com/ca).

The partners and managers in National Accounting and Assurance are:

Carolyn Anthony	416 815 5266	carolyn.anthony@ca.pwc.com
Brooke Ayer	416 814 5793	brooke.ayer@ca.pwc.com
Scott Bandura (Calgary)	403 509 6659	scott.bandura@ca.pwc.com
Martin Boucher (Montréal)	514 205 5415	martin.boucher@ca.pwc.com
Sean Cable	416 814 5831	sean.c.cable@ca.pwc.com
Michel Charbonneau (Montréal)	514 205 5127	michel.a.charbonneau@ca.pwc.com
David Clément (Montréal)	514 205 5122	david.clement@ca.pwc.com
Jerome Donny	416 815 5069	j.donny@ca.pwc.com
Larissa Dyomina	416 869 2320	larissa.dyomina@ca.pwc.com
Will Foster (Vancouver)	604 806 7183	william.p.foster@ca.pwc.com
Sophie Gaudreault	416 815 5236	sophie.gaudreault@ca.pwc.com
Kerry Gerber (London & Toronto)	519 640 7902	kerry.d.gerber@ca.pwc.com
	416 365 8834	
Doug Isaac (Vancouver)	604 806 7710	douglas.c.isaac@ca.pwc.com
Vicki Kovacs	416 941 8363	vicki.kovacs@ca.pwc.com
Robert Marsh (Vancouver)	604 806 7765	robert.marsh@ca.pwc.com
Rosemary McGuire	416 869 2599	rosemary.mcguire@ca.pwc.com
Claire Patra (Calgary)	403 509 7356	claire.a.patra@ca.pwc.com
Jim Saloman	416 941 8249	james.s.saloman@ca.pwc.com
Sherrie Shaw	416 365 8809	sherrie.m.shaw@ca.pwc.com
Mike Tambosso	416 941 8388	michael.a.tambosso@ca.pwc.com
Michael Walke	416 815 5011	michael.walke@ca.pwc.com
Gary Van Haren	416 814 5717	gary.van.haren@ca.pwc.com
Andrew White	416 941 8479	andrew.white@ca.pwc.com
Chris Wood	416 365 8227	christopher.r.wood@ca.pwc.com

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