

St. Lawrence Centre for the Arts
Year-end Report to the Finance Committee
December 31, 2010

April 25, 2011

Members of the Finance Committee of the Board of Management
St. Lawrence Centre for the Arts

Dear Members of the Finance Committee

We have substantially completed our audit of the financial statements of The St. Lawrence Centre for the Arts (the "Centre" or the "Organization") 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 finance our key findings.

We would like to express our sincere thanks to the management and the staff of the Centre 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 finance 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: Jim Roe, 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 item	Status as at May 2, 2011
i. 2010 electricity contract	
ii. Receipt of accounts receivable confirmations - Toronto Operetta Theatre - Opera in Concert	
iii. Review of additional expenses	
iv. Legal letters from lawyers: - City of Toronto	
v. Subsequent events update with management	
vi. Receipt of signed management representation letter	
vii. Approval of the financial statements by the finance committee / board of management	

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	<ul style="list-style-type: none"> • We identified several areas of focus in our audit plan. We will provide an update to the audit committee on the following areas: <ul style="list-style-type: none"> - Treatment of related party transactions - Deferred revenue and capital contributions - Payroll 	Section 2
ii.	Summary of unadjusted items	<ul style="list-style-type: none"> • We identified several unadjusted items during the audit. As a result, we estimate that the deficit is understated by \$29,560, compared to our overall materiality of \$62,000. • In our opinion, the financial statements, taken as a whole, are free of material misstatement. 	Section 3

	Issue	Summary discussion	For further reference
iii.	Control recommendations	<ul style="list-style-type: none">• We noted the following significant deficiencies in internal controls that we have discussed with management:<ul style="list-style-type: none">◦ Manual journal entries◦ Review of year-end bank reconciliations◦ Lack of petty cash policy◦ Management expense reports approval◦ Timely elimination of employees from system◦ Supporting documents for standing data changes◦ Overall segregation of duties	Section 5
iv.	Independence	<ul style="list-style-type: none">• We are independent of the St. Lawrence Centre for the Arts as at April 25, 2011, and our independence letter can be found in Appendix C.	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 finance 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 have discussed the following items with management:

Issue	Discussion
Human resources matter	<ul style="list-style-type: none"> • At the meeting on May 2, we will provide additional information with respect to a human resources matter to be discussed in camera.
Treatment of related party transactions	<ul style="list-style-type: none"> • 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 received in the year, the year-end receivable balance and loan payable balance to the City. • Based on our review of the confirmation received, all amounts have been accurately and completely reflected in the financial statements and accounts of the Centre. • As part of our controls testing, we also reviewed the business performance review controls of the Centre, focused on quarterly reporting with the City. As a result of our controls work, no significant issues were noted.
Deferred revenue and capital contributions	<ul style="list-style-type: none"> • 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 the Centre. Capital investment fund ticket surcharges (CIF) of \$2.50 per ticket. Our testing indicated that the sample tested had been accurately recorded and deferred at year end as restricted to the Centre for the purchase of capital assets. • Deferred revenues (which include advance ticket sales and customer deposits received from theatre guests and performances respectively, and which have not yet been earned) were both tested on a sample basis to underlying records - no exceptions were noted.
Payroll	<ul style="list-style-type: none"> • We reviewed the key controls over the payroll cycle with respect to the provision of information to ADP, the payroll service provider, the review of information provided by ADP and the recording of

Issue	Discussion
	<p>amounts in the financial records.</p> <ul style="list-style-type: none"> • Control recommendations resulted from our testing over standing data changes with respect to new hires and terminations and review of time cards. Refer to section 5 of report • We obtained the section 5970 report on the operating effectiveness of controls at ADP and reviewed it to ensure that the controls that pertain to the amounts recorded in the financial statements of the Centre were operating effectively. No issues were noted. • 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.

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 finance 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 identify any such items.

a. Unadjusted items

Total unadjusted items have a net effect increasing the deficit from operations by \$29,560. The materiality level (as previously communicated to you) is \$62,000.

Description	Excess of revenue over expense	Statement of financial position		
		Assets (over) under stated	Liabilities over (under) stated	Net assets over (under) stated
To record capital leases:				
- Interest expense	4,940			
- Amortization expense	12,104			
- Property, plant & equipment		116,490	(96,247)	
- Obligations under capital lease				(37,287)
- Fund balances				
To record interest expense related to loan with City of Toronto	12,516	-	(12,516)	-
Total unadjusted differences	29,560	116,490	(108,763)	(37,287)

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 receivable and payable HST advances	-	(14,737)	14,737	-
To net receivable and payable balances related to subscriptions	-	(36,050)	36,050	-
Total adjusted differences	-	(50,787)	50,787	-

4. Other required communications

Canadian Auditing Standards require that the external auditor communicate certain matters to the finance 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 Centre:

Matter to be communicated	PwC's response
Management's representations	<ul style="list-style-type: none"> • Under Canadian Auditing Standards, we are required to inform you of the representations we are requesting from management. A copy of the management representation letter is included in Appendix B.
Significant difficulties or disagreements that occurred during the audit	<ul style="list-style-type: none"> • No difficulties or disagreements occurred while performing our audit that require the attention of the finance committee.
Fraud and illegal acts	<ul style="list-style-type: none"> • Management has discussed with us one instance of fraud which was discovered in the year. Other than this, no fraud came to our attention as a result of our audit procedures. • We wish to reconfirm whether the finance committee is aware of any known, suspected or alleged incidents of fraud other than the item discussed above.

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 identified the following recommendations that we have discussed with management and wish to bring to your attention.

Control item	Recommendation	Management's response
<p>Manual journal entries During the course of our testing over information technology general controls, we noted that the finance director has preparation and review privileges of manual journal entries. Although we did not note any instances of journal entries being prepared and reviewed by the same person, the existence of this ability to do so in the system increases the risk of management override of controls.</p>	<p>We recommend the controller have only review access, so that only approval can be initiated. We recommend another member of the accounting team prepare the manual journal entries.</p>	<p>Management agrees with this recommendation and will review system access privileges to the system accordingly.</p>
<p>Review of December 31 bank reconciliation During our testing of reconciliation, we noted three year-end bank reconciliations lacking evidence of review or approval.</p>	<p>We recommend that the individual who prepares the bank reconciliations to be different from the individual who reviews and approves the reconciliations. Review by way of signature and/or dating is recommended.</p> <p>We also recommend that bank reconciliations per reviewed shortly after preparation in order to provide useful information to management.</p>	<p>Management is in the process of hiring a new accountant, whose role will include performing the reconciliations, in order to allow the controller to review prepared work.</p> <p>Management has also developed a ten day cycle following period-ends, during which all month-end procedures are expected to take place.</p>
<p>Petty cash policy & control log Currently, there is no formal policy in place for managing petty cash. Petty cash at December 31, 2010 was \$5K. This increases the risk</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</p>	<p>Most significant expenses are incurred through Amex credit card use. However, the Centre will aim to create a policy for</p>

<p>of misappropriation of the petty cash balance.</p>	<p>that this log be reconciled and reviewed on a regular basis.</p>	<p>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 to the control log will be performed on a regular basis</p>
<p>Management expense reports approval During our testing of the authorization of management expense reports, we noted several instances where the finance director had approved her own expense report. Although our review indicated that the nature of the expense approved may have been reasonable, there is a risk of misappropriation of assets where expense reports can be self-approved.</p>	<p>We recommend that all staff and management expense reports, including Amex expenses, be approved by someone other than the individual who has incurred the expense.</p>	<p>Management agrees that no manager will be able to approve their own management expense reports going forward.</p> <p>A new credit card policy will be updated to include an appropriate signature authorization policy.</p>
<p>Timely elimination of employees from system 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 controller 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>Supporting documents for standing data changes During our testing of payroll controls, we noted that supporting documents for payroll changes to crew members were not prepared. This increases the risk of incorrect data being entered into the system with respect to pay rates, hiring and termination dates.</p>	<p>We recommend that offer letters and records of employment be created for employees that are hired or terminated. This creates a paper trail of all pertinent details that are sent to and processed at ADP.</p>	<p>Management agrees with this recommendation and will look to update its policies around documentation preparation and retention for hiring, terminations and salary changes.</p>
<p>Overall segregation of duties Due to the size of the Centre, we noted many areas where the reporting and accounting functions are performed by the finance director. This increases the risk of error and possibility for management override of controls.</p>	<p>We recommend that the controller delegate certain responsibilities to the accounting team, or other capable staff, with the appropriate training. This will enable the finance director to independently review the work prepared by the staff. We also recommend that the work of the finance director be reviewed periodically.</p>	<p>Management is in the process of hiring one more individual to the accounting team for support, and to improve the overall segregation of duties at the Centre.</p>

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

St. Lawrence Centre for the Arts

Financial Statements
December 31, 2010

DRAFT

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

May 26, 2011

Independent Auditor's Report

**To the Board of Directors of
St. Lawrence Centre for the Arts**

We have audited the accompanying financial statements of St. Lawrence Centre for the Arts, which comprise the balance sheet as at December 31, 2010 and the statements of operations, changes in net assets 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 in our audit 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 St. Lawrence Centre for the Arts as at December 31, 2010 and the results of its operations and its 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 an unqualified opinion in their report dated March 31, 2010.

Chartered Accountants, Licensed Public Accountants

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

St. Lawrence Centre for the Arts

Balance Sheet

As at December 31, 2010

	2010 \$	2009 \$
Assets		
Current assets		
Cash	106,489	258,149
Short-term investments (note 3)	5,016	-
Accounts receivable (note 11)	148,003	178,835
Due from City of Toronto		
Trade receivables	1,309	1,309
Net operating deficiency (note 6(b))	255,821	108,104
Inventories	6,908	7,493
Prepaid expenses	34,448	37,690
	557,994	591,580
Capital assets (note 4)	3,685,202	4,018,453
	4,243,196	4,610,033
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	139,559	230,897
Due to City of Toronto		
Trade payables (note 6(a))	293,484	293,641
Loan (note 6(c))	160,528	224,239
Advance ticket sales	332,763	279,457
Customer deposits	15,465	103,271
Obligations under capital lease (note 10(a))	8,372	2,991
	950,171	1,134,496
Obligations under capital lease (note 10(a))	28,264	-
Deferred capital contributions (note 5)	3,249,041	3,426,382
	4,227,476	4,560,878
Net assets		
Internally restricted for capital purchases (note 7)	15,720	49,155
	4,243,196	4,610,033
Commitments (note 10)		

On Behalf of the Board

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

 Director

St. Lawrence Centre for the Arts

Statement of Operations

For the year ended December 31, 2010

	2010 \$	2009 \$
Revenue		
Funding from City of Toronto	1,420,200	1,497,873
Operating		
Labour services	1,137,629	1,214,583
Rental	497,584	524,418
Ancillary	346,952	364,410
Amortization of deferred capital contributions	396,663	410,629
Other	27,182	57,012
	<u>3,826,210</u>	<u>4,068,925</u>
Expenses		
Salaries, wages and benefits (note 8)	2,572,948	2,627,050
Presentation and production	39,866	41,505
Ancillary	95,486	128,330
Building operations	675,367	648,733
Administration	286,486	304,257
Interest on loan payable - City of Toronto (note 6(c))	-	10,000
Amortization of capital assets	439,267	454,478
	<u>4,109,420</u>	<u>4,214,353</u>
Deficiency of revenue over expenses before the following	(283,210)	(145,428)
Recoverable from the City of Toronto (note 6(b))	246,952	108,104
Deficiency of revenue over expenses for the year	<u>(36,258)</u>	<u>(37,324)</u>

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

St. Lawrence Centre for the Arts

Statement of Changes in Net Assets
For the year ended December 31, 2010

	2010		
	Internally restricted for capital purchases	Unrestricted	Total
	\$ (note 7)	\$	\$
Net assets - Beginning of year	49,155	-	49,155
Deficiency of revenue over expenses for the year	-	(36,258)	(36,258)
Interfund transfers (note 7)	(36,258)	36,258	-
Vida Peene Fund	2,823	-	2,823
Net assets - End of year	15,720	-	15,720
	2009		
	Internally restricted for capital purchases	Unrestricted	Total
	\$ (note 7)	\$	\$
Net assets - Beginning of year	86,479	-	86,479
Deficiency of revenue over expenses for the year	-	(37,324)	(37,324)
Interfund transfers (note 7)	(37,324)	37,324	-
Net assets - End of year	49,155	-	49,155

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

St. Lawrence Centre for the Arts

Statement of Cash Flows

For the year ended December 31, 2010

	2010 \$	2009 \$
Cash provided by (used in)		
Operating activities		
Deficiency of revenue over expenses for the year	(36,258)	(37,324)
Add (deduct): Items not involving cash		
Amortization of capital assets	439,267	454,478
Amortization of deferred capital contributions	(396,663)	(410,629)
	6,346	6,525
Net change in non-cash working capital balances (note 9)	(120,087)	265,738
	(113,741)	272,263
Investing activities		
Purchase of capital assets	(106,016)	(338,445)
Net decrease in investments	(5,016)	51,686
	(111,032)	(286,759)
Financing activities		
Contributions restricted for the purchase of capital assets	222,145	177,643
Increase in loan payable - City of Toronto	(63,710)	-
Repayment of obligations under capital lease	33,645	(6,525)
	192,080	171,118
Net increase (decrease) in cash during the year	(32,693)	156,622
Cash - Beginning of year	258,149	101,527
Cash - End of year	225,456	258,149

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

St. Lawrence Centre for the Arts

Notes to Financial Statements

December 31, 2010

1 Operations and relationship with the City of Toronto

St. Lawrence Centre for the Arts (the Centre) is an agency of the City of Toronto (the City) and was incorporated on May 27, 1968 without share capital. The Centre is a non-profit organization incorporated to maintain and operate as an artistic, cultural, social, educational and recreational facility for the benefit of the City and its inhabitants and the public interest.

The Centre consists of two theatres which are used by a number of resident companies and casual renters for a wide-variety of theatrical, musical, dance and corporate events from both the not-for-profit and private sectors. The Centre also programs public affairs events under the banner of the in-house operated "St. Lawrence Centre Forum". As part of the terms of the agreement between the Centre and the City, any operating excess or deficiency is to be transferred to or recovered from the city (note 6).

The major capital facilities of the Centre are owned by the City and therefore are not recorded in these financial statements. Expenditures for major improvements to the Centre are accounted for by the Centre as building improvements (note 4) and are financed primarily through the Centre's Capital Improvement Reserve Fund (CIF) which was established to record ticket surcharges introduced in 1987 (note 5).

The Centre is a non-profit organization and, as such, is not subject to income taxes under Section 149(1) of the Income Tax Act (Canada).

2 Summary of significant accounting policies

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles applied within the framework of the significant accounting policies summarized below:

Revenue recognition

The Centre follows the deferral method of accounting for contributions which includes funding from the City. 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 deferred capital contributions on the balance sheet.

Rentals, labour services and ancillary revenues are recognized on the date of the performance or event or at point of sale.

Deferred revenue consists of deposits for rental revenue for future performances. Once the performances occur, the deposits are recorded as revenue from operations.

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

St. Lawrence Centre for the Arts

Notes to Financial Statements

December 31, 2010

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 are payable to the rental clients and are included in trade accounts payable.

Investments and investment income

Investments are recorded at fair market value. Transactions are recorded on a settlement date basis and transaction costs are expensed as incurred.

Investment income includes interest, and realized and unrealized gains and losses on investments.

Inventories

Inventories are recorded at the lower of cost, recorded on a first-in, first-out basis, and net realizable value.

Capital assets

Capital assets are recorded at cost and contributed capital assets are recorded at fair value at the date of contribution. Amortization is provided on a straight-line basis over their estimated useful lives as follows:

Computer equipment	3 to 5 years
Furniture and fixtures	5 to 10 years
Building improvements	25 years

Assets leased on terms that transfer substantially all of the benefits and risks of ownership to the Centre are accounted for as capital leases, as though the asset had been purchased and a liability incurred. All other leases are accounted for as operating leases.

Employee benefits

Contributions to multi-employer defined contribution pension plans are expensed when due.

Contributed materials and services

Because of the difficulty of determining their fair value, contributed materials and services are not recognized in the financial statements.

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

St. Lawrence Centre for the Arts

Notes to Financial Statements

December 31, 2010

Financial instruments

The Centre has designated its financial instruments as follows:

- cash as held-for-trading;
- short-term investments as held to maturity;
- accounts receivable and due from City of Toronto as loans and receivables; and
- accounts payable, accrued liabilities and due to City of Toronto as other liabilities.

Derivative financial instruments

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

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, 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.

3 Investments

Short-term investments consist of guaranteed investment certificates.

4 Capital assets

Capital assets consist of the following:

	2010		
	Cost	Accumulated	Net
	\$	amortization	\$
		\$	\$
Computer equipment	606,717	415,559	191,158
Furniture and fixtures	2,163,157	1,627,082	536,075
Building improvements (note 6(c))			
Exterior	892,635	145,747	746,888
Interior	3,113,445	902,364	2,211,081
	<u>6,775,954</u>	<u>3,090,752</u>	<u>3,685,202</u>

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

(3)

St. Lawrence Centre for the Arts

Notes to Financial Statements

December 31, 2010

	2009		
	Cost	Accumulated	Net
	\$	amortization	\$
		\$	\$
Computer equipment	548,446	275,729	272,717
Furniture and fixtures	2,125,513	1,506,150	619,363
Building improvements (note 6(c))			
Exterior	892,635	110,042	782,593
Interior	3,103,345	759,565	2,343,780
	<u>6,669,939</u>	<u>2,651,486</u>	<u>4,018,453</u>

Computer equipment includes assets with a cost of \$72,590 (2009 - \$32,623) held under capital leases. Accumulated amortization relating to these assets amounted to \$34,621 (2009 - \$28,275).

During 2009, the Centre disposed of capital assets with an original cost of \$94,793 and accumulated amortization of \$94,793 for no proceeds. The cost and related accumulated amortization have been removed from the financial statements. There were no disposals in 2010.

5 Deferred capital contributions

Deferred capital contributions represent the unamortized amount of donations, grants and amounts included in the cost of each ticket sold that is restricted for the purchase of capital assets. The following sets out the change in the deferred capital contributions balance during the year:

	2010	2009
	\$	\$
Balance - Beginning of year	3,426,382	3,659,368
Amortization of deferred capital contributions	(396,663)	(410,629)
Contributions restricted for the purchase of capital assets	219,322	177,643
	<u>3,249,041</u>	<u>3,426,382</u>

6 Related party transactions, City of Toronto

- a) In the normal course of operations, the Centre incurred costs of \$478,487 (2009 - \$414,791) which are included in the statement of operations, for various expenses payable to the City such as hydro, maintenance and other administrative costs. In addition, the City will utilize the Centre for various business purposes throughout the year and this is recorded as revenue of the Centre. This amounted to \$@@@ (2009 - \$@@@).

Transactions between the City and the Centre are made at agreed upon exchange amounts.

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

(4)

St. Lawrence Centre for the Arts

Notes to Financial Statements

December 31, 2010

- b) As part of the terms of the agreement between the Centre and the City, any operating excess or deficiency is to be transferred to or recovered from the city (note 1). The changes during the year are as follows:

	2010 \$	2009 \$
Due to City of Toronto - Beginning of year	108,104	119,165
Receipt of 2009 deficit (2009 - receipt of 2008 deficit)	(99,235)	(119,165)
Deficiency of revenue over expenses recoverable from the City 2010	246,952	108,104
Due to City of Toronto - End of year	<u>255,821</u>	<u>108,104</u>

- c) In 2006 and 2007, the Centre substantially completed a major renovation of the interior and exterior of its building. In 2008, the Centre completed west signage as the final stage of the renovation.

In 2006 and 2007, renovations were financed by a grant from the city, CIF contributions restricted for capital purposes and an advance from the city. In 2008, a loan agreement was finalized for the remaining funding from the city. The loan related to the project was \$241,988 with a principal repayment of \$63,711 in 2010 (2009 - \$nil). The loan bears interest at 5% per annum and is due on June 30, 2012. Total interest paid on the loan for the year ended December 31, 2010 was \$12,516.

7 Net assets internally restricted for capital purchases

Net assets internally restricted for capital purchases represents amounts set aside by the Centre to fund future capital asset purchases and to cover the net amortization of deferred capital contributions and the related capital assets.

The Centre is among eight organizations which receive distributions from the estate of Vida Peene. During 2010, the Centre received distributions of \$2,823 (2009 - \$nil). The distribution from the estate is to be used at the discretion of the Board of Directors of the Centre.

In the current year \$36,258 (2009 - \$37,324) of these costs were transferred from the unrestricted fund to the net assets internally restricted for capital.

8 Employee benefits

The Centre's administrative employees participate in a defined contribution pension plan. This plan is separate from the IATSE pension plan and is administered by Manulife. The Centre's contributions to this plan were \$49,109 (2009 - \$50,477) which is expensed and included within salaries, wages and benefits on the statement of operations.

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

(5)

St. Lawrence Centre for the Arts

Notes to Financial Statements

December 31, 2010

The Centre also makes contributions to a defined contribution pension plan administered for the stage employees. Contributions to this plan were \$62,836 (2009 - \$64,764). In addition, the Centre contributes fixed amounts into a plan established by the union representing the stage employees for health, dental, and sick leave benefits. Contributions for these benefits amounted to \$36,696 (2009 - \$40,414). A portion of these pension and benefit contributions are recovered through patrons renting the facilities at the Centre as these are direct costs of those patrons and not the Centre. Any amounts not recovered are included within salaries, wages and benefits on the statement of operations.

9 Statement of cash flows

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

	2010 \$	2009 \$
Accounts receivable	30,832	(35,266)
Inventories	585	1,481
Prepaid expenses	3,242	34
Accounting payable and accrued liabilities - trade	91,338	52,691
Due from/to City of Toronto	(211,585)	179,730
Advance ticket sales	53,307	(26,993)
Customer deposits	(87,806)	94,061
	<u>(120,087)</u>	<u>265,738</u>

10 Commitments

a) Capital lease obligations

Future minimum annual lease payments under a capital lease for telephone equipment are as follows:

	\$
Total minimum lease payments for 2010	38,530
Less: Imputed interest	<u>1,894</u>
Present value of minimum lease payments	36,636
Less: Current portion	<u>8,372</u>
	<u>28,264</u>

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

St. Lawrence Centre for the Arts

Notes to Financial Statements

December 31, 2010

b) Lease commitments

Future minimum annual lease payments for equipment under operating leases are approximately as follows:

	\$
2011	33,521
2012	33,521
2013	33,521
2014	<u>26,717</u>
	<u>127,280</u>

11 Financial instruments

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

Accounts receivable are exposed to credit risk since there is a risk of counterparty default. The Centre provides an allowance for doubtful accounts to absorb potential credit losses. As at December 31, 2010, three accounts represent 78% of the total accounts receivable balance (2009 - two accounts represented 63.4%).

The Centre is exposed to changes in electricity prices associated with the 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.

12 Trust fund

Victor C. Polley Scholarship Fund

In 1981, the Centre was appointed as trustee for the Victor C. Polley Scholarship Fund (the Fund), which was created for the purpose of awarding a scholarship annually to a deserving student of arts management or arts administration. The Fund, which has a balance of \$7,254 (2009 - \$7,238), has not been included in the Centre's balance sheet nor have its operations been included in the Centre's statement of operations.

13 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.

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

St. Lawrence Centre for the Arts

Notes to Financial Statements

December 31, 2010

14 Comparative figures

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

DRAFT

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

Appendix B: Management representation letter

[Please insert STLC Letterhead]

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

May 26, 2011

We are providing this letter in connection with your audit of the financial statements of St. Lawrence Centre for the Arts (the Centre) as of December 31, 2010 and for the year 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 with the City of Toronto and related entities, including the Centre, 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 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 accounts have been eliminated or appropriately measured and considered for disclosure in the financial statements.

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 held was November 22, 2010;
- 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 STLC 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 STLC'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, 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 STLC's related parties and the relationships with such parties.

All accounts confirmed 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 notes to 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.

We confirm that the financial statements are free of material misstatements, including omissions.

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 \$405,133 and are considered to be fully collectible, except to the extent of \$11 in respect of which full allowance has been made in the accounts.

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*.

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.

Inventory

Inventories recorded in the financial statements are stated at the lower of cost or net realizable value, cost being determined on the basis of FIFO, with due provision recorded to reduce all damaged, wholly or partially obsolete, or unusable inventories to their estimated selling price less estimated cost to sell. Inventory quantities at the statement of financial position date were determined from physical counts or from the Centre's perpetual inventory records, which have been adjusted on the basis of physical inventories taken by competent employees at various times during the year. Liabilities for amounts unpaid are recorded for all items included in inventories at statement of financial position dates and all quantities billed to customers at those dates are excluded from the inventory balances.

Leases

The Centre has recorded contingent rent expense under leases for which the achievement of the specified target that triggers the contingent rent is considered probable.

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 STLC'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 consolidated 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 its obligations under capital lease, and loan payable 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.

The Centre has not violated any covenants on or during any of the periods reported. We have fully disclosed to you all covenants and information related to how we determined our compliance with the terms of the covenants.

Unearned revenue and deferred credits

All material amounts of unearned revenue and deferred credits 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

Yours truly,

St.Lawrence Centre for the Arts

Jim Roe, General Manager

Hayde Boccia, Controller

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		
	Over (under) stated	Assets (over) under stated	Liabilities over (under) stated	Net assets over (under) stated
To record capital leases:				
- Interest expense	4,940			
- Amortization expense	12,104			
- Property, plant & equipment		116,490		
- Obligations under capital lease			(96,247)	
- Fund balances				(37,287)
To record interest expense related to loan with City of Toronto	12,516	-	(12,516)	-
Total unadjusted differences	29,560	116,490	(108,763)	(37,287)

Appendix C – Summary of Adjusted Misstatements (SAM)

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 AR & AP HST advances	-	(14,737)	14,737	-
To net AR & AP balances related to subscriptions	-	(36,050)	36,050	-
<i>Total adjusted differences</i>	-	<i>(50,787)</i>	<i>50,787</i>	-

Appendix C: Independence letter

April 25, 2011

Members of the Finance Committee
St. Lawrence Centre for the Arts
27 Front Street East
Toronto, ON M5E 1B4

Dear Committee members:

We have been engaged to audit the financial statements of the St. Lawrence Centre for the Arts (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 arising since November 1, 2010, the date of our engagement letter with the City of Toronto and its entities, including the Centre.

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 to April 25, 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 25, 2011.

This report is intended solely for the use of the Finance Committee, management, and others within the Centre and should not be used for any other purposes.

Yours very truly,

Pricewaterhouse Coopers 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 GNPO 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.

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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
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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.
(Q1) or (Q2) = quarter of expected release of standard	

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 ...

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