



THE PRACTITIONER'S VIEW

Vol. 5, Issue 5 May 2004

ACCOUNTING and ASSURANCE STANDARDS - UPDATE

CAmagazine's May 2004 issue included a summary of all accounting and assurance standards issued from January through April 2004, as well as a list of all documents for comment outstanding as at April 2004. Standards issued include:

Accounting Standards	Effective Date	
Employee Future Benefits, Section 3461 (amended)	Period Ending	June 30, 2004
Financial Instruments – Disclosure and Presentation, Section 3860 (amended)	Beginning	November 1, 2004
Accounting Guidelines (AcG)		
Equity-Linked Deposit Contracts – AcG 17	Ending	November 1, 2003
Investment Companies – AcG 18	Beginning	July 1, 2004
Emerging Issues (EICs)		
Revenue Recognition – EIC 141	Beginning	December 17, 2003
Revenue Arrangements with Multiple Deliverables – EIC 142	Beginning	December 17, 2003
Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts – EIC 143	Beginning	December 17, 2003
Accounting by a Customer (including a Reseller) for Certain Consideration Received from a Vendor – EIC 144	Ending	August 15, 2004
Assurance Standards		
Audit of Financial Statements – An Introduction, Section 5090*	Ending	December 15, 2003
The Auditor's Responsibility to Consider Fraud and Error, Section 5135*	Ending	December 15, 2003
Auditor Review of Interim Financial Statements, Section 7050	Beginning	April 1, 2004
Reports on the Application of Accounting Principles, Section 7600*	Reports issued	May 1, 2004

* see accompanying article

AUDIT OF FINANCIAL STATEMENTS – AN INTRODUCTION SECTION 5090

The main revision to this section is the deletion of the assumption of management's good faith.

As well, there is stronger emphasis on the audit being approached with an attitude of professional skepticism:

- It is NOT the auditor's objective to prove management's honest and integrity, although these attributes contribute to an effective operation of the financial reporting process.
- Corroborating evidence for management's representations should generally be obtained, notwithstanding prior experience with management and responses to enquiries resulting from performance of analytical procedures.
- Auditors should NOT usually be viewing the actions of those charged with governance as a primary source of audit evidence. This is because those charged with governance act in the interest of the entity and do not normally have control over an entity's day-to-day operations.

This Section has been revised to take effect with respect to audits of financial statements and other financial information relating to periods ending on or after DECEMBER 15, 2004.

Practitioner's View is a regular publication of the Institute of Chartered Accountants of Nova Scotia to inform and to serve members who are involved in public accounting in Nova Scotia.

AUDITOR'S RESPONSIBILITY TO CONSIDER FRAUD AND ERROR - SECTION 5135

This Section has been updated significantly to bring Canadian standards into line with International standards concerning Fraud and Error. Since CICA Handbook Sections 5130 (Materiality and Audit Risk in conducting an audit), 5135, and 5136 (Misstatements – Illegal Acts) are interrelated, it is important that all sections be read in the context of each respective section and respective appendices.

Effective Date

The 5135 standards are effective for periods ending on or after DECEMBER 15, 2004. Therefore these standards should be in place now.

The principal changes to this Section are:

- More emphasis on the respective responsibilities of auditors, management, and those charged with governance with respect to fraud;
- Greater guidance on assessing the risks of misstatement due to fraud, including requirements to make enquiries of management and others within the entity, and understanding the role of those charged with governance;
- Discussion of earnings management;
- Greater emphasis on managements ability to override internal controls and management fraud generally;
- Classification of fraud risk factors into factors relating to incentive to commit fraud, opportunity to commit fraud and the ability to rationalize the fraudulent act;
- Requiring procedures to be performed to address managements ability to override internal controls; in particular, the testing of journal entries, reviewing accounting estimates for bias and understanding of the business rationale for significant transactions outside the normal course of business; and
- Requiring procedures to be performed to address the presumed risk of improper revenue recognition.

The Section also includes three appendices, which are very extensive and should be required reading as well as a handy reference for all professional staff:

- 1) Appendix A provides examples of risk factors relating to the two types of fraud relevant to the auditor;
- 2) Appendix B provides examples of possible audit procedures to address the assessed risks of material misstatement due to fraud resulting from both fraudulent financial reporting and misappropriation of assets;
- 3) Appendix C provides examples of circumstances that indicate the possibility of fraud and error.

A thorough summary of the requirements of this updated section, prepared by the Institute of Chartered Accountants of Alberta (ICAA), may be viewed at:

<http://weblink.icaa.ab.ca/pdf/AuditorsResponsibilityMAY2004.pdf>.

REPORTS ON THE APPLICATION OF ACCOUNTING PRINCIPLES - SECTION 7600

This revised Section applies to engagements in which a reporting accountant (being other than the incumbent accountant) provides a written report or oral advice on:

- a) the application of accounting principles to a specific transaction, or
- b) the type of opinion that may be rendered on an entity's financial statements after an entity has already obtained guidance from its incumbent accountant on the matter.

The guidance in Section 7600 helps to ensure that reporting and incumbent accountants have access to the same information in order to minimize the risk of the reporting accountant giving inappropriate guidance because of limited knowledge of relevant facts and circumstances.

Situations To Which Section Does Not Apply

It does not apply to the following:

- a) engagement in which:
 - a public accountant is assisting an entity to prepare GAAP based financial statements, by providing the entity with a written report/oral advice on the application of accounting principles to a specific transaction, AND
 - the entity has not already obtained guidance from its incumbent accountant on the matter

- b) engagement to assist in:
 - litigation involving accounting matters or expert testimony in connection with such litigation
 - the usual work of receivers and trustees in bankruptcy , or
 - inspection or disciplinary process of provincial institutes/ordre
- c) professional advice provided to another accountant in public practice
- d) communications such as position papers (prepared to present views on an issue involving the application of accounting principles or the type of opinion that may be rendered) NOTE: The section would apply if such position papers were intended as guidance on the application of accounting principles to a specific transaction or on the type of opinion that may be rendered on a specific entity's financial statements.

A reporting accountant should not undertake an engagement to provide a written report or oral advice on the application of accounting principles to a hypothetical transaction. (7600.06)

This is a change from the former section in which generic opinions were permitted.

New Guidance

New guidance is provided on:

- oral advice, including illustrative examples of questions for a practitioner to consider in determining if he or she is providing oral advice, and situations a practitioner may encounter when an entity requests oral advice (Appendix B);
- the type of opinion that may be rendered on a specific entity's financial statements; and
- the inclusion of a separate paragraph, at the end of the report, that indicates that the report is intended solely for the information and use of specified parties, identifies the parties to whom use is restricted, and indicates that the report is not intended to be, and should not be, used by anyone other than the specified parties, or for any other purpose (Appendix A).

Effective Date

The Recommendations in the revised Section apply to reports dated on or after MAY 1, 2004.

DIFFERENTIAL REPORTING – PRIMER

If you have clients that qualify for differential reporting, consider the following questions?

- Are you aware of all the differential reporting options available? While there are 7 options available, often only one or two are adopted.
- Have you reviewed your client base to determine which clients may benefit from using a Differential Reporting option(s) and discussed it with each client well in advance of their next year-end?
- Has a consent letter been obtained? Was it signed **before** any work commenced? Was it addressed to management rather than the practitioner?
- Have you used the correct wording for the assurance engagement report?
- Have you listed Differential Reporting options in the engagement letter?
- Have you listed Differential Reporting options in the representation letter?

PROFESSIONAL ENGAGEMENT MANUAL UPDATE

Update #33, the most recent revision to the Professional Engagement Manual, was issued in March. Highlights of the update focus mainly on changes regarding the new independence standard and the new privacy rules.

Compilation Engagements

This section has been updated to reflect the new independence standards:

- Revised engagement letter (Appendix B)
- Sample wording for situations where there is an impairment of independence (Appendix C)
- Revised *Compilation and Engagement Planning and Completion Checklist* (Sample Forms - Appendix A)

Review and Audit Engagements

These sections and appendices were updated to reflect the new independence standard and included other wording modifications reflecting current standard practices:

- Independence letter for review engagements
- Revised engagement letters for audit and review engagements
- Revised representation letters for audit and review engagements

Future Oriented Financial Information (FOFI)

- Revised engagement letter (Appendix B)

Practice Management

This section has been updated to reflect the new privacy rules:

- Personal Information Protection Compliance Checklist (Appendix A)
- Sample Privacy Policy (Appendix A)

Sample Forms

- Review and audit engagements - independence checklists
- Review engagement – planning the review engagement
- Review and audit engagement – client retention checklists

The above forms replace interim checklists provided with the *Focus on PEM* newsletter of January 2004.

- New review and audit programs – Property, Plant and Equipment; separate programs for entities that have and have not adopted the new accounting standards for asset retirement obligations.
- Going Concern checklist – New

In addition, forms have changed to include guidance on guarantees and risks. Practitioners are advised to use the most recent forms available to ensure full compliance with CICA Accounting and Assurance Recommendations.

Model Financial Statements – General Purpose for Small Business Enterprises

The fifth edition of this publication has been revised to reflect the major changes and new standards up to release No. 23 of the *CICA Handbook – Accounting* and release No. 16 of the *CICA handbook – Assurance* revisions issued in June 2003.

COMPILATION ENGAGEMENTS – SUBJECT TO INDEPENDENCE RULES

You do not need to be independent to conduct a compilation engagement. However, the Rules of Professional Conduct require disclosure of any impairment of independence.

*Where disclosure is required, a **second paragraph** should be added to the Notice to Reader.*

The Professional Engagement Manual provides examples of wording to address various independence situations that follow the types of impairment (prohibitions and threats) outlined in the Rules of Professional Conduct. This has been reprinted as Supplementary Information: A.

CONTINGENT FEES AND RELATED INDEPENDENCE ISSUES

The following article appeared in the Spring 2004 issue of CheckMark, a publication of the Institute of Chartered Accountants of Ontario and is reprinted with the permission of ICAO.

When considering if an engagement can be billed on a contingent fee basis, members engaged in the practice of public accounting OR in a related business or practice should refer to Rule of Professional Conduct 215. Contingent fee arrangements are NOT permitted for engagements for which the member or firm is required to be independent (i.e., assurance engagements), or for compilation engagements. Further, a contingent fee is not permitted if it creates a threat to independence, with respect to an assurance engagement, that cannot be reduced to an acceptable level through the application of safeguards or if it may influence the results of a compilation engagement.

Preparing a SR&ED claim creates a self-review threat to independence when the results of the service are incorporated into the client's financial statements that are subject to audit or review. Preparing this claim on a contingent fee basis increases the significance of this threat.

Rule 204.2 requires the member or firm to evaluate the significance of each threat. The significance will depend on factors such as:

- the materiality of the SR&ED claim; the extent of the client's knowledge, experience and ability to evaluate the issues concerned, and the extent of the client's involvement in determining and approving significant matters of judgment;

- the degree of subjectivity inherent in preparing the claim. Preparation of SR&ED claims generally requires significant judgment. For instance, there is judgment involved in assessing whether amounts are eligible expenditures or not and in assessing the amount of time people spent on a project in SR&ED. Once the claim is prepared, further judgment is required with respect to determining the probability of the amount being received and its materiality, and therefore whether the amount should be set up as a receivable in the financial statements. The complexity of and the judgment required in preparing SR&ED claims creates a self-review threat to independence;
- the reliability and extent of the underlying data; and
- the extent and clarity of the financial statement disclosures.

If the threat is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include involving an additional professional accountant who was not a member of the engagement team to review the SR&ED claim or otherwise advise as necessary, obtaining the client's acknowledgement of responsibility for the results of the SR&ED claim prepared by the firm or arranging that members of the firm providing such services do not participate on the engagement team.

If the member or firm determines that these safeguards are not sufficient to reduce the threat to an acceptable level, then the member or firm must not prepare the SR&ED claim or must decline the assurance or compilation engagement.

If you have fully reviewed all available material, and still have questions about its application to a specific situation, discuss the situation with a colleague or with the Director of Professional Standards. Please remember that the ultimate decision on an independence matter rests with the member, and the Institute staff members are unable to assume any responsibility, or provide approval, for a specific situation. As a member service, however, we will direct members to relevant Rules, Council Interpretations, and other available guidance that the member should consider in arriving at a conclusion.

UPDATED FEDERAL ELECTION GUIDANCE

The following article was prepared as a Member Advisory, a publication of the Institutes of Chartered Accountants of Alberta and Saskatchewan and is reprinted with the permission of ICAA and ICAS. Opinions expressed in the bulletin are those of the author and do not reflect the official position of the Institutes.

To reflect the changes enacted in June 2003, including the changes in the rights and responsibilities of federal candidates, official agents and auditors, the CICA has recently released a revised *Guide for the Auditor of a Candidate in a Federal Election*.

The guide is divided into six sections

- 1) Accounting requirements and related issues
- 2) Returns, declarations and other related matters pertaining to the submission of required forms and reimbursement of election expenses
- 3) Special considerations describing the administrative requirements of the *Canada Elections Act* (Act) when a candidate withdraws or a candidate, official agent or claimant dies.
- 4) The audit of the candidate, which reviews the requirements of the Act and problems likely to be encountered and provides extensive and practical guidance for conducting the audit.
- 5) The auditor's report
- 6) The use by a candidate of the electronic return

An auditor of a candidate should be reviewing the *Elections Canada Election Handbook for Candidates, Their Official Agents and Auditors* before conducting the audit.

Caution

In view of differences between federal and provincial legislation, it is not appropriate to rely on this guide for the audit of a candidate in a provincial election. In those provinces where independent audits of provincial candidates are required, respective provincial issued guidance exists.

Any member contemplating involvement in the forthcoming election in the capacity of either a candidate, official agent or auditor, should be obtaining a copy of this guide and reading it thoroughly.

A copy can be obtained from CICA at www.cica.ca/index.cfm/ci_id/17150/la_id/1.htm

WIRELESS INTERNET NETWORKING – CAUTION

If you are thinking of going wireless, you should be aware of a new and disturbing trend called “war driving”, discussed in the following article in the AccountingWEB’s News Wrap-Up for February 19, 2004.

The image is enticing, a modern day Norman Rockwell portrait. Your children are upstairs on the home computer, and you and your spouse are downstairs in the den, each with your own laptop — everyone comfortably sharing the same Internet connection, and everyone getting the individual computer time that they need in today’s fast paced world. Wireless networking is now affordable for everyone, and as a result, thousands of consumers have recently or will soon set up a wireless network. But there is a dark side to this convenience, one that could cost you money, time and reputation. If you have a home computer network, read on.

Most consumers are a little leery of the technical prowess they perceive is needed to set up a home network. However, once they plug in the hardware and follow the initial instructions, they are delighted when they get an Internet connection — and most tend to stop there when they are “successful.” They don’t realize that the wireless signal doesn’t stop at the walls of their house, and they don’t take that last and crucial step — changing the manufacturer’s default password and access code. In similar scenes that are repeated every day across the country, the “security” aspect of what these delighted homeowners have just done makes network administrators cringe from head to toe.

What our average consumer has just done is provided Internet accessibility to anyone within striking distance, opening up their connection and even their computers to neighborhood hacks. This is today’s equivalent of leaving your car running with the doors unlocked, the windows down and the garage door open. And for those who have malicious intent, you may as well have a big neon sign in the front yard that says “Free Internet — and See My Computer’s Content Too! Want to see pictures of my kids? See my financial records? Get access to my password list? Then click your computer now...”

“War driving” Is a new and disturbing term given to those who literally drive around neighborhoods with a laptop and wireless card looking for vulnerable wireless networks. With simple equipment available to anyone, “war drivers” simply drive up to your house, plug into your connection and access any computers that are not secure. There are “how to” sites on the Internet instructing anyone on what they need to do to hijack a home network.

The concern, however, is not limited to just home networks. Unbelievably, the issue is rampant with business wireless networks as well. In a recent report done by our local NBC television affiliate, driving through any neighborhood, corporate office park or downtown business district provided similar access to wireless networks, and they were successful for tapping in to both home as well as business computers.

Take this article as a red flag — a flare sent up to help you avoid massive problems down the road. If you have a wireless network, or are considering setting one up, be sure you do all you can to protect yourself.

PROFESSIONAL STANDARDS REVIEW - FEES

The Council of the Institute of Chartered Accountants of Nova Scotia has approved a fee increase for the 2004 professional standards review period to \$125 per hour. This increase, the first since 1999, coincides with the beginning of the sixth cycle of the program.

GOODWILL IN PUBLIC PRACTICE FIRMS - SURVEY

A survey of goodwill in public practice firms, carried out in autumn of 2003 by the Institute of Chartered Accountants of British Columbia (ICABC), provides information on trends and considerations for practitioners everywhere thinking of purchasing a practice, a block of accounts, an interest in a firm, or a merger of two or more practices. ICABC stress that the survey is simply a collection of data and is not intended to serve as a guide to what practitioners should pay.

See Supplementary Information: B for highlights.

SUGGESTIONS FOR THE NEXT ISSUE?

Contact **Wenda Bennett, CA** at the Institute wbennett@icans.ns.ca or (902) 425-3291.

PROFESSIONAL ENGAGEMENT MANUAL
COMPILATION ENGAGEMENTS – CHAPTER 2
APPENDIX C (Page 1 Of 2)

Examples of suggested wording for the Notice to Reader communication where there is an impairment of independence. The examples follow the various types of impairment (prohibitions and threats) outlined in the Rules of Professional Conduct.

PROHIBITIONS	DISCLOSURE – SAMPLE WORDING
<p>Financial Interests Members of the engagement team (and immediate family members) may not have a financial interest, as defined, in an assurance client or related entity.</p>	<p><i>A partner in the firm is a shareholder of ABC Company Ltd.</i></p> <p><i>A relative of a manager in my firm is a shareholder of ABC Company Ltd.</i></p>
<p>Loan Guarantees The firm and members of the engagement team may not have a loan, or a loan guarantee to or from an assurance client or a related entity.</p>	<p><i>The owner, ABC Company, has provided a loan guarantee to a partner in the firm.</i></p> <p><i>ABC Company has provided an interest-free loan in the amount of \$XX 000 to a manager in the firm.</i></p>
<p>Business Relationships The firm and members of the engagement team may not have a close business relationship with an assurance client, unless the relationship is limited to an immaterial financial interest that is insignificant to the client, the firm or the member.</p>	<p><i>ABC Company purchases building materials at wholesale prices from a company owned by a close relative of a staff member in this firm.</i></p> <p><i>Our firm has been engaged to provide litigation support services to ABC Company.</i></p>
<p>Family Members Members of the engagement team may not have an immediate family member in a position with the client where that person would be able to influence the subject matter of the assurance engagement.</p>	<p><i>A close relative of a senior staff member of my firm is a loans officer at ABC Bank, where ABC Company maintains its line of credit.</i></p> <p><i>The husband of Ms. X, CA, a partner in this firm, is an employee of ABC Company.</i></p>
<p>Staff Positions Members of the engagement team must not be an officer or director of the client, or an employee of the client in a position to influence the subject matter of the assurance engagement, during the period covered by the engagement. As well, other members of the firm may not be officers or directors of an assurance client.</p>	<p><i>A relative of a partner on our firm is director of ABC Company.</i></p>
<p>Services Provided Members and firms may not provide:</p> <ul style="list-style-type: none"> • Legal services that involve dispute resolution of matters that are material to the financial statements of audit and review clients; and • Corporate finance services such as dealing in, promoting, or buying/selling an assurance client's securities. • 	<p><i>We provide corporate finance and valuation services for ABC Company.</i></p>
<p>Management Functions Members and firms are prohibited from performing, management functions (as described) for an assurance client.</p>	<p><i>We perform financial management functions for ABC Company.</i></p>
<p>Accounting Services Members and firms must obtain client management approval for the making of journal entries, accounting classifications, etc. The creation of original or source documents such as cheques, invoices, etc. is prohibited.</p>	<p><i>During the extended illness of the owner of ABC Company, we prepared sales invoices, monthly financial statements, and filed various compliance reports.</i></p>
<p>Gifts Members and students on the engagement team and the firm may not accept other than insignificant gifts or hospitality from an assurance client.</p>	<p><i>One of our senior staff accepted an all-inclusive vacation at one of the ABC Company properties as a gift.</i></p>

PROFESSIONAL ENGAGEMENT MANUAL

COMPILATION ENGAGEMENTS – CHAPTER 2

APPENDIX C (Page 2 of 2)

THREATS TO INDEPENDENCE	DISCLOSURE – SAMPLE WORDING
<p>Self-Interest Threat A self-interest threat occurs when the firm or a person on the engagement team could benefit from a financial interest in, or another self-interest conflict with, an assurance client. Circumstances that may create a self-interest threat include having a direct financial interest or material indirect financial interest in the assurance client.</p>	<p><i>A partner of our firm is one of four trustees of the ABC Family Trust, which is the sole shareholder of ABC Company Ltd.</i></p> <p><i>The fees we receive from ABC Company are material to our practice.</i></p> <p><i>A partner in our firm is a shareholder in a company that has provided loan guarantees to ABC Company Ltd.</i></p>
<p>Self-Review Threat A self-review threat occurs when any product or judgment from a previous engagement needs to be evaluated in reaching conclusions in the particular assurance engagement. Circumstances that may create a self-review threat include there being a person on the engagement team being, or having recently been, an employee of the assurance client in a position to exert influence over the subject matter of the engagement.</p>	<p><i>The wife of a partner in our firm served as a director of ABC Company from 19XX to 20XX.</i></p> <p><i>A staff member of our firm was the Director of Finance for ABC Company until June 20XX.</i></p>
<p>Advocacy Threat An advocacy threat occurs when a firm, or person on the engagement team promotes an assurance client’s position or opinion to the point that objectivity may be, or may be perceived to be, impaired. This would occur if the judgment of a person on the engagement team were to be subordinated to that of the client. Circumstances that may create an advocacy threat include the dealing in, or being a promoter of, shares or other securities of the assurance client.</p>	<p><i>Our firm is providing expert testimony on behalf of ABC Company in legal proceedings.</i></p> <p><i>Our firm has been engaged to value the issued and outstanding common shares of ABC Company and search for a potential buyer for those shares.</i></p> <p><i>Our firm has been engaged to assist ABC Company in preparing a prospectus-offering document for a private placement debt issue.</i></p>
<p>Familiarity Threat A familiarity threat occurs when, by virtue of a close relationship with an assurance client, its directors, officers or employees, a firm or a person on the engagement team becomes too sympathetic to the client’s interests. Circumstances that may create a familiarity threat include there being a person on the engagement team having an immediate or close family member who is a director or officer of the assurance client.</p>	<p><i>A partner in my firm is a business associate and close friend of Mr. Y, the sole shareholder of ABC Company.</i></p> <p><i>A staff member is the co-founder, along with a director of ABC Company, of a non-profit organization.</i></p>
<p>Intimidation Threat An intimidation threat occurs when a person on the engagement team may be deterred from acting objectively and exercising professional skepticism by threats, actual or perceived, from the directors, officers or employees of an assurance client. Circumstances that may create an intimidation threat include the threat of being replaced due to a disagreement with the application of an accounting principle.</p>	<p><i>Due to a disagreement on the application of the revenue recognition policy, ABC Company has threatened to dismiss us as accountants. We are currently working with ABC Company to resolve these issues.</i></p> <p><i>ABC Company has threatened to file a legal action against our firm.</i></p>

GOODWILL SURVEY

A survey of goodwill in public practice firms, carried out in autumn of 2003 by the Institute of Chartered Accountants of British Columbia (ICABC), provides information on trends and considerations for practitioners everywhere thinking of purchasing a practice, a block of accounts, an interest in a firm, or a merger of two or more practices. ICABC stress that the survey is simply a collection of data and is not intended to serve as a guide to what practitioners should pay.

Highlights include:

Trends

Compared to a similar survey carried out in 1992, the number of transactions over the past ten years has dropped, suggesting that there is not a very active market for the purchase and sale of practices.

Method

The goodwill paid for a practice or block of accounts is in the 66% to 76% range of gross annual fees, depending on the method used. From the results indicated in the table below, it is clear that members prefer to calculate goodwill using the gross historical fees method. However, this should not be taken as the recommended or correct method of calculation. There were no transactions reported using the net profit method. (*Reminder:* Each transaction is unique and all terms and conditions are negotiable. This survey is an indication of past practice for such transactions; it is **not** a template).

Type of transaction	Ratio of Goodwill Amount to Fees	
	Historical Fees	Future Billings
Purchase of a practice	76.5%	68.3%
Purchase of a block of accounts	76.0%	65.7%

Retention Clause

	Purchase of a practice	Purchase of a block of accounts	Purchase of a partnership interest	Merger of practices
Percentage of transactions that included a clause to reduce the amount paid in the event of non-retention of clients	59.6%	71.4%	17.9%	14.3%
Average number of years clause is in effect	2.3 years	2.2 years	1.4 years	1 year
Retention of actual revenue dollars over term of retention clause: 90-100% 70-89%	57.7% 26.9%	40.0% 40.0%	80.0% 20.0%	100.0%
Percentage of responses where there was a bonus to the vendor (practice) for billings in excess of the amount negotiated	11.6%	7.7%	4.2%	-

Restrictive Covenant

	Purchase of a practice		Purchase of a block of accounts	
	%	Details	%	Details
Percentage of responses where there was a restrictive covenant or non-competition clause imposed on vendor	80.9%		57.1%	
Type of restrictions Acting for former clients	55.3%			
Geographical area - average distance from office in kilometers	76.3%	77 km		
Period of time - average number of years	81.6%	4.2 years		3.8 years
Percentage of response where covenant involved a penalty to vendor for violation	43.2%		75.0%	

GOODWILL SURVEY (ICABC)

(Page 2 of 3)

Major Considerations in arriving at price and terms of Goodwill

(May have more than one answer so total exceeds 100%)

Factors	Purchase of a practice	Purchase of a block of accounts	Purchase of an interest	Merger of practices
Expected client retention rate	76.7	41.7		
Good reputation of vendor (practice)	58.1	41.7	70.8	100.0
Perceived opportunity to improve profitability	53.5	50.0	25.0	85.7
Type of client work done	46.5	41.7	37.5	71.4
Profile of client base	41.9	16.7	25.0	28.6
Vendor's current charge out rates	34.9	33.3		
Existing profitability of practice (accounts)	23.3	16.7	75.0	
Practice(s) successful and growing	18.6	8.3	70.8	100.0
Willingness of vendor to remain with firm	18.6			
Abilities of vendor's (party's) staff	18.6			57.1
Age and condition of office premises, equipment and improvements	9.3			42.9
Terms of existing lease on premises	9.3			42.9

General

1. Percent of responses reasonably satisfied with deal made 90.4%

2. Changes if do all over again
(May have more than one answer so total exceeds 100%)

Changes	Percentage of responses
Include retention rate over a reasonable period of time as part of calculation	34.5
Exclude certain types of work from calculation	27.6
Give more consideration to age of clientele	24.1
Monitor billings more closely	24.1
Give more consideration to vendor's charge-out rates and billings	20.7
Gain better understanding of quality and type of services provided by vendor to gauge likely client retention	20.7
Vary price for different types of work in practice	13.8
Include non-compete clause and define penalties	13.8
Be more diligent about checking out other party's reputation, quality of work, etc.	13.8
Pay different rate for different clients	10.3

3. Effectiveness of purchase
Retention rate of revenue dollars over a period (percent of responses)

	90-100%
1 year	77.0
3 years	62.5
5 years	57.8

GOODWILL SURVEY (ICABC)

(Page 3 of 3)

4. Other advice to potential purchasers (Presented without edit)

- Age of clients is important, as many elderly clients have had their companies wound-up during the last 3-4 years.
- Bargain harder and review client files. Do a few of the vendor's files before committing to anything.
- More contact with purchased clients to improve retention.
- Base price on net income, not gross fees. Include retention clause. Avoid profit splits based on gross fees.
- Watch the ability of future partners to share profits, staff, and clients. Discuss future plans for additional partners.
- Payment should be gauged according to retention likelihood.
- Ensure that you are protected from both net income and/or gross income fluctuations, so either use a retention base calculation or an earn-out calculation for goodwill.
- Spend as much time up front getting to know prospective partners and their practice habits.
- Put in place from the start (in partnership agreement) a formal mechanism to ensure regular communication between partners to air issues as they arise.
- Make every attempt to discuss how the transaction should be structured with outside knowledgeable parties so you can benefit from their experience.
- Make sure that the vendor's practice fits your practice profile and that clients will perceive this.
- Involve the seller for 3 to 6 months. Make contact with all new clients right away. Be aware of risk of losing larger clients.
- The retention and succession of clients is probably the most important thing to focus on. Don't just focus on price/rate to be paid.
- Make sure that you include an adjustment clause if business does not materialize. Spread payments out so that adjustments are known before dollars paid out.
- Recovery of time spent on clients is more important than gross billings. Ensure firm is recovering close to charge out rate on clients. Exclude not-profitable clients from purchase price.
- There is an opportunity cost in purchasing a practice as it distracts you from marketing services to new or existing clients and may get you a practice you are not perfectly compatible with.
- Consider going into partnership with a sole practitioner as part of a succession plan. The partnership period allows for a smooth transition and better client retention than a straight purchase.
- Don't assume you can recover at previous year's billings.
- Remember that each acquisition is unique & treat it that way. Do not, if possible, retain partners from acquired practice.
- Make sure you can work with the group of partners you are joining since it is a long-term commitment. Consider working with the firm beforehand.
- Look for a fit from a personality standpoint and long-term potential/stability of the firm and its partners. This will outweigh short term financial shortcomings.
- Get to know your future partner's goals and business philosophies - any hidden agendas, prima-donna complex, personality quirks, personal health.
- Structure deal so that goodwill is priced before tax. Base total price on future billings to retain clients. Tie payments to collections.
- Expect to lose some clients. You want to lose the "D" clients so make sure you know how many of them there are.
- Ensure legal agreements are all in place. Discuss major issues before closing deal. Identify non-negotiable issues early on.
- Culture of the two firms is more important than anything else.