

Sorting Beans from Hasbeens

During a brutally dry third-year accounting lecture I was struggling through, an exhausted-looking student at the back of the class interrupted the professor and begged: "Could you possibly slow down a little bit for those of us who did drugs in high school?" The comment drew chuckles, but the instructor, who had the personality of an ironing board, pressed on.

As a rule, business school was challenging, and the accounting students were among our brightest, even if some of them seemed like an entirely different breed to me. The co-op accounting students wore suits and ties to school, carrying professional quality brief cases, storming the academic halls as if they had just birthed out of a Bay Street subway station late for a power lunch. My hand-me-down jeans with socks and sandals matched my PBJ mid-day meal stuffed into my broken-zipped pack sack. But each to his own.

This microcosmic class structure among business students soon dissipated (mostly) once we were all wearing ties to work. My banking job required parsing, dissecting, decoding and untangling financial statements seemingly all day long for 19 years running. Each statement became a bit like a puzzle, the solution to which is revealed by answering with some precision: 1) Is this business viable? And 2) where did all the money go?

This process required running our own calculations, sifting through explanatory notes, and jotting down a few questions, some of which could best be answered by the accountant. Since we were usually going through several years of data at a time, sometimes for several interconnected corporations, the phone call to the accountant might go something like:

"On Note 7 on page 14 of the 2013 financial statement for Scooby Doobie Inc. there was an intercompany transfer between Scooby or Inc. and Shaggy Inc. for \$257,321. Was this a discretionary transfer for tax reasons, or an inter-company transaction for services rendered?"

Invariably, without hesitation the accountant would recall the transaction from four years earlier, then go on to explain it, delving into the tax legislation motivating it.

Levels of engagement in financial reporting vary widely, and accounting protocols require clear and upfront identification as to the depth of their dive into the data. Readers should look for the clearly-written verbiage on the front of the report, crucial for would be buyers of businesses, investors, partners, or lenders. First ask: How much work was this accounting firm hired to do here? Then ask: What exactly are you buying? Hopefully a reliable stream of profits for the years ahead, but is it?

The lowest level of financial due diligence is used in preparing a Notice to Reader statement. That title is essentially a disclaimer, warning readers that all that was done here was to take the information the management team provided and compile it into a standard format. Also referred to as compiled statements, the Chartered professional accountants of BC note that, "... a compilation is essentially the process of gathering financial information from the client and assembling them..."

Higher up the due diligence ladder is the Review Engagement Report. With this report the accounting team affirms that a moderate level of accuracy has been verified, but stops short of the rigour of a full audit. According to Shajani LLP, a Calgary accounting firm, "The benefit of a review engagement is the added level of assurance on the financial statements (which) may be requested by lenders, investors and management if significant decisions are being based on the financial statements.

The gold standard for financial statement preparation is the Audit Report. Here a deeper level of verification on the part of the accounting firm is undertaken, whereby they are in a position to state their

professional opinion as to the accuracy of the information at hand. These are required by all public ally traded firms, and many others who rely on external investors and partners at significant levels.

Only properly trained and certified accountants are qualified to give these higher levels of reports. Making business purchase or investment decisions on information that is either hearsay or unverified could be very expensive tuition, and is inherently packaged with all the additional risks of not having the information sorted out by qualified professionals on your behalf.

There are also even higher levels of certified specialties in areas related to taxes, cross-border issues, estate planning, and so forth. Individuals who find themselves facing these challenging issues will quickly learn that it is important to hire the right person for the job.

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