

Countdown

Deloitte Canada's IFRS transition newsletter



Welcome to the November 2009 edition of Countdown! We now have only a few weeks to go before January 1, 2010, when many Canadian publicly-accountable enterprises (PAEs) will cross the starting line on IFRS conversion, with the first order of business being development of opening balance sheets under IFRS. Our recent publication, [20 Things To](#)

[Do Before 2010](#), has been well-received, and I hope has been helpful as you plan your conversions.

With recent decisions by the International Accounting Standards Board (IASB) to defer work on a major project to improve accounting for income taxes, our lead article this month relates to the implications of this for Canadian companies going through transition.

Also in this month's edition, the Lightyear implementation team focuses on accounting for share options and other share-based payments, one of the remaining key areas for which they need to have a more detailed understanding as to how the rules work under IFRSs. With their advisors, they will focus on the existing differences between current Canadian generally accepted accounting principles (GAAP) and IFRSs.

As always, we want to continue to understand and meet your needs, so please submit ideas regarding matters that you would like to see us address in Countdown to deloitteifrs@deloitte.ca.

See you again next month!



Don Newell
National Leader - IFRS services

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The "Tax-ing" Route to IFRS



On October 28, 2009, at the joint Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) meeting, the IASB discussed its income tax project and more specifically the comments received on the IAS 12 *Income taxes*, Exposure Draft (ED) that was issued earlier this spring. The IASB staff summarized the comments received and noted that there was very little support from respondents for finalizing the ED in its current form. This was reaffirmed at the IASB meeting on November 17th. The ED will not go forward as proposed.

So what is going to happen?

Many respondents questioned whether the IASB should be spending time on this project given the Board's heavy agenda and the pressure to complete other projects. At the November 17th IASB meeting, the IASB Staff recommended considering limited amendments on IAS 12 on issues that cause particular problems in practice, more specifically limiting the scope of the project to accounting for uncertain tax positions. The recommendation was to carry out this work after the IASB finalizes the current project to revise IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

The Board did not agree with the staff proposal to limit the work to uncertain tax positions. Several Board members encouraged the Board to broaden the scope of its work to include the most pressing issues – notably the issue of the tax effect of property revaluations that has been of concern in some jurisdictions.

What is the impact for Canadian companies transitioning to IFRS?

The demise of the ED will have a significant impact on Canadian companies transitioning to IFRS. Canadian companies finally have certainty that the existing IAS 12 will be the accounting standard to transition to (other than uncertain tax positions), and also that the requirements in the existing accounting standard, IAS 12, are in many ways less onerous to implement than the proposed ED for many companies.

IAS 12, in its existing format, may still prove to be a challenging standard to implement, as there are specific issues that can result in significant differences, and in particular given the increased disclosure requirements. Some companies may or may not currently have the processes in place to readily collect and track the required information in the disclosures.

Canadian companies will also need to continue to monitor the activities of the IASB in the short-term specifically as it relates to uncertain tax positions and other short-term projects. While existing IAS 12 does not include explicit guidance on uncertain tax positions, many companies use the recognition and measurement guidance included in IAS 37 when determining the appropriate accounting for uncertain tax positions. Companies that are currently reporting under IFRS and account for uncertain tax positions under IAS 37 or analogize to that guidance will need to monitor the changes in accounting under the current IAS 37 project for changes in the recognition and measurements standards, and again when specific guidance is released for uncertain tax positions as part of IAS 12.

The IASB staff also raised additional practice issues beyond those identified in the ED that they viewed as requiring some attention in the future. Canadian companies should continue to monitor developments in these areas if any of the following transactions are relevant to them:

- Property revaluations in jurisdictions with no capital gains tax (or where the tax rate on capital gains differs significantly from the rate on normal income)
- Deferred taxes for single asset entities

- Initial temporary differences arising when the same transaction gives rise to both a liability and an asset
- Use of an undistributed rate for entities such as real estate investment trusts and co-operative societies; and
- Recovery of an asset partly through use followed by sale.

Next steps

The IASB asked a small group of its members to investigate priority issues for a short-term project and consider possibilities for short-term convergence. The IASB will delay a fundamental review of income taxes until resources become available, and likely in conjunction with the FASB.

The Real Deal

Stock Compensation



Lightyear has a number of share-based payment arrangements in place and this month the implementation team is focused on understanding any differences between the accounting treatment under IFRSs relative to Canadian GAAP as well as the business impacts that they might need to consider. Any kind of compensation is a sensitive area since, unlike many other financial statement items, it has a direct impact on the employees or management of the Company that are in receipt of such payments. The Lightyear Compensation Committee has asked the implementation team to prepare a presentation to them which considers:

- The key differences between IFRSs and Canadian GAAP on this area;
- The significance of these differences to Lightyear; and
- The possible additional considerations that the compensation Committee need to consider – particularly in the area of internal management reporting and performance measures as well as necessary communications.

The Lightyear team has reached out to their Deloitte advisor, Hugh Guardian, to find out what's the deal and how do they keep things real?

What's the Deal?

Share-based payments include the following: share options (granted to employees or to non-employee service providers), share appreciation rights, deferred and restricted share units and employee share ownership plans, etc. Essentially they encompass any kind of payment which is given by a company in shares or is in some manner linked to the value of the shares of the company. They may be settled in cash, shares or some combination thereof.

The applicable guidance on accounting for share options and other share-based payment transactions is IFRS 2 *Share-based Payment*. The general concepts of IFRS 2 are consistent with Canadian GAAP (CICA 3870 *Stock-based Compensation and Other Stock-based Payments*) – share-based payments made to employees are considered to be compensation and expensed over the period that they are considered to be “earned” by the employee, use of fair value is prevalent and stock option valuation models commonly employed under Canadian GAAP (e.g. binomial, Black-Scholes) are also acceptable under IFRSs. There are however some key differences and in many instances IFRS 2 is more restrictive than Canadian GAAP – the scope is slightly broader and available choices under Canadian GAAP sometimes do not exist under IFRS 2.

IFRS 2 will need to be applied retrospectively at Lightyear; there is an IFRS 1 exemption that should be considered but while it may have some applicability it will not alleviate much of the work effort that is involved in this exercise.

Keeping it Real!

Lightyear has a number of share-based payment arrangements in place as well as prior transactions in which share-based payments have been given by the Company. The details are summarized in below:



Current arrangements in place:

- Share option awards granted to Senior Management of the Company over each of the last five years. The exercise price of the options was equivalent to the market price of Lightyear's shares at the date the awards were granted. Each of the awards exercisable only when the recipient has completed a five year service period starting from the date of the grant (cliff vesting). Once exercisable, there is a three year period during which the recipients may exercise the options. Thereafter the rights expire.
- An employee share purchase plan is available to all employees of the Company. Due to its features, it is considered to be non-compensatory under Canadian GAAP and therefore there are no CICA 3870 accounting requirements for this plan under Canadian GAAP. Under the terms of this arrangement the employees are able to purchase shares at a discount of 3% below market price.
- Share appreciation rights granted to certain members of management each year as part of their compensation packages for the year. The rights are settled in cash, if exercised, with an exercise price that is fixed at the market price of the rights at the date of grant. The awards require a three year service period from the date of grant before they are all able to be exercised. However, unlike the Senior Management awards, the ability to exercise is built up on a cumulative basis over a three year period with ¼ of the awards being exercisable on the date of grant and ¼ of the awards will become exercisable on each anniversary of the grant date over the three year period.

Management currently accounts for the share options using the fair value method of accounting and the share appreciation rights using the intrinsic value model. The employee share purchase plan is considered to be non-compensatory and any discount given is treated as a reduction to the proceeds received for the share issuance rather than as compensation expense. A recap of some of the key terms that are applicable to Lightyear's arrangements and a comparison to IFRSs is set out in the table below:

Term	Current Policy	IFRS Considerations
Intrinsic value	<p>Intrinsic value is the amount by which the market price of the underlying stock exceeds the exercise price of an option. For example, an option with an exercise price of \$20 on a stock whose current market price is \$25 has an intrinsic value of \$5.</p> <p>Under Canadian GAAP, Lightyear accounts for its share appreciation rights using an intrinsic value method. This method does not require the use of an option pricing model.</p>	<p>IFRS 2 has a comparable definition of intrinsic value but unlike Canadian GAAP requires that all share-based payment transactions be recorded at fair value unless, in the instance of equity based awards, fair value is unable to be reliably measured.</p> <p><i>Lightyear will need to reassess its current methodology for accounting for its stock appreciation rights and account for these at fair value under an IFRS compliant policy.</i></p>
Graded Vesting	<p>Graded vesting refers to the disaggregation of a grant of share-based awards when it contains awards that vest at specific intervals over the life of the grant as a whole. For example, the management share appreciation rights referred to above are exercisable between one and three years after the date they were granted to an employee.</p> <p>Lightyear accounts for each tranche (i.e. each ¼ of the awards) as a single grant of share-based payments and recognizes the compensation expense associated with each tranche based on its respective vesting period (this accounting treatment is referred to as the "accelerated method").</p>	<p>As noted in the Canadian GAAP analysis, the accelerated method is currently applied by Lightyear. This is good news for Lightyear as the requirement to account for graded vesting awards is more restrictive than under Canadian GAAP – there is no accounting alternative for graded vesting awards.</p> <p><i>Lightyear currently uses the accelerated method to account for its graded vesting awards and therefore its policy complies with the requirements of IFRS 2 in this regard.</i></p>

Term	Current Policy	IFRS Considerations
		<p><i>(Note that Canadian GAAP also permits, under certain circumstances, a simplified method of accounting for share-based payments with graded vesting which many Canadian companies currently follow (which is to treat for the entire grant as a single award (i.e. ignoring the fact that each tranche has a different vesting period) and recognize the associated expense over the vesting period on a straight-line basis) . Had Lightyear been following this simplified method, they would have been required to record a transition adjustment upon the adoption of IFRS for unvested share-based payment awards (provided that Lightyear will apply the IFRS 1 exemption, see discussion below) that are still outstanding on the transition date to adjust the accounting to comply with the graded vesting requirements).</i></p>
Non-compensatory	<p>Canadian GAAP considers certain arrangements to be non-compensatory if available to substantially all employees, the purchase discount is 5% or less than the share price of the Company and certain other criteria apply. Such arrangements are not expensed but rather the discount from issuance is treated as reduction of the share proceeds.</p>	<p>IFRS 2 contains no exemptions. All payments to employees are considered to be compensatory and need to be treated in the same way as other share-based payment transactions with employees.</p> <p><i>This means Lightyear will need to re-assess the accounting treatment of its employee share purchase plan to determine the impact at transition and update its accounting policy for this plan.</i></p>
Forfeitures	<p>Forfeitures refer to share-based payments for which the counterparty does not fulfill the vesting conditions. Under Canadian GAAP, no expense should be recognized for share-based payments that are forfeited. Canadian GAAP permits an accounting policy choice whereby an entity can either recognize share-based payment expenses based on an estimated forfeitures (and “true-up” the estimate as actual or more accurate information becomes available) or account for forfeitures as they occur.</p> <p>Lightyear currently recognizes share-based payment expenses based on an estimated forfeitures.</p>	<p>IFRS does not provide similar accounting policy choice as Canada GAAP. Under IFRS, companies are required to recognize expenses associated with share-based payments based on estimated forfeitures.</p> <p><i>Lightyear’s current accounting policy complies with this IFRS requirement.</i></p>
Fair value	<p>Both Canadian GAAP and IFRS specify the requirement to fair value share-based payments made to employees and non-employees. IFRS differs in that fair value is required for substantially all such transactions with minimal exception (see reliably measurable limitation discussed above). Current Canadian GAAP, on the other hand, permits the use of minimum value (which is a value that excludes the effects of volatility of the underlying share) under certain circumstances.</p> <p>The good news for Canadian companies already employing fair value (Lightyear uses fair value for its share option arrangements) is that share-option pricing models commonly used under Canadian GAAP will often continue to be acceptable under IFRSs. Some detailed application aspects of the models are more rigid under IFRSs (for example, volatility is always required to be incorporated into these models) and accordingly a careful review of the guidance will be required to ensure all necessary details are addressed.</p> <p><i>Lightyear uses the binomial model for determining the fair value of its share option arrangements. The implementation team will nonetheless review the details to ensure that the current model captures all relevant requirements necessary under IFRS 2.</i></p>	

Lightyear recognizes this is not a simple area of accounting but also notes that the general concepts, and many of the details, are aligned. This puts the team in a good position to draft Lightyear's IFRS share-based payment policy note and implement IFRS-compliant accounting.

The team also notes, that this addresses go forward accounting but there is still the question of retrospective application. Hugh, their Deloitte advisor, provides them with an overview of an IFRS 1 *First-time Adoption of International Financial Reporting Standards* exemption that is available for share-based payment transactions. Unfortunately, however, it is date specific (the dates are really much more relevant for those who transitioned to IFRSs in 2005) and while still helpful, it will still require some effort to analyze the retrospective application impact.

The IFRS 1 exemption allows retrospective application to be avoided for the following:

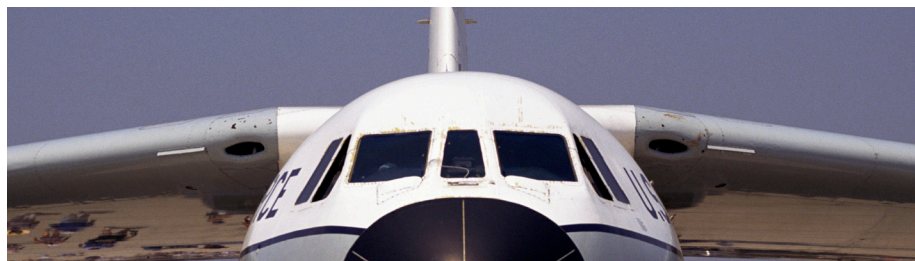
- Cash-settled awards that vest before Lightyear's date of transition; and
- Equity settled awards that were granted prior to November 7, 2002 or after this date but which had vested prior to the date of transition.

The implementation team considers the above and decides that it may be worthwhile electing these exemptions, albeit that since it largely applies to awards of Lightyear that have now vested, any impact may be expected to be limited to retained earnings. The team prepares to complete the retrospective application analysis for the remainder of the awards that will be outstanding at transition. The team has also carefully considered whether or not the grandfathering relief they obtained upon the adoption of CICA 3870 relates to any instruments which will still be outstanding on the date of transition and therefore require additional analysis.

The other aspect of Lightyear's considerations regarding IFRS 2 relates to any impact on the structuring of these awards in future and how any impact, either at transition or under IFRS reporting, could impact the performance measurement reporting of the Company. To the extent that share-based compensation measurement changes (for example, a move to a fair value model or the requirement to expense previously non-compensatory plans) this will have a direct impact on the earnings of the Company which needs to be considered. The Lightyear team decides they will first take a high level review of this matter through the following article in Countdown and then re-contact Hugh to decide how to effectively combine the accounting with the performance management considerations in their presentation to the Compensation Committee.

See our article on performance measurement which complements Lightyear's IFRS 2 analysis and watch out for more on Lightyear in our December 2009 issue of Countdown - the last issue prior to Lightyear's date of transition!

Performance measurement under IFRS



IFRS will provide new and, many would argue, better financial disclosures to the external stakeholders for such information. From an investor's perspective, this information will be used as a key input to valuation models, which should allow for better buy/hold/sell decisions. Investors generally tend to be well versed in this process and, while different, IFRS disclosures should not be a major challenge... but when it comes to internal measurement and management of performance, the challenge may be different and present a more difficult transition.

Most organizations drive their internal performance measures and management reports from a base that starts with GAAP financial statements. Adjustments and allocations are made to this data to arrive at disaggregated business unit and functional results, so that performance can be assessed against the specific accountabilities assigned within the organization. This performance is typically compared to plans, forecasts and external benchmarks to determine the relative performance of each area. However, when companies move to IFRS based statements, the starting point will in many cases have moved quite significantly.

This creates a challenge as companies will have to revisit their existing measures and their performance management processes to ensure that they have actual results, plans, forecasts and benchmarks that are meaningful and comparable using the new IFRS statements as a starting point. In some circumstances, companies may decide that certain IFRS adjustments will not initially be incorporated into internal performance measures and metrics, especially those which drive employee compensation, to ensure that unusual or inequitable compensation results do not occur during the transition period. They will also have to consider how to address trend data given the older historical information will potentially no longer be comparable. Over time, there will also be a need to revisit the performance measures used for incentive compensation to ensure that companies are in fact incenting value-creating behavior. All of this will likely require education of not only those who prepare the information but of those who use it to judge performance and make decisions.

On a positive note companies could take this opportunity to revisit their performance measures and management processes to make significant improvements. Given that consistent, value-aligned performance management has been elusive in many companies, this improvement in the management process could be an opportunity as significant as ERP was to the improving operational processes. The 'glass is half full' approach could yield significant benefits to those companies who view IFRS as more than just a regulatory requirement.

Public sector government business enterprises required to use IFRSs

The Public Sector Accounting Board (PSAB) has confirmed that government business enterprises (GBEs) – public sector enterprises with self-sustaining, commercial-type operations – will be required to follow IFRSs for periods beginning January 1, 2011.

The existing category of government business-type organizations (GBTOs) will cease to exist, resulting in re-categorization as either government not-for-profit organizations or other government organizations (OGOs). As a result, such organizations will be permitted to choose to prepare their financial statements in accordance with public sector standards or IFRSs based on needs and objectives.

Adoption of new financial reporting standards for these government organizations is effective for fiscal years beginning on or after January 1, 2011. This coincides with the adoption of IFRSs in the private sector.

Deferral of the consolidation project

At the end of October, the IASB and FASB agreed to conduct their respective consolidation projects jointly. They also decided that it would be beneficial to discuss all remaining issues together at one meeting which is currently scheduled for January 2010. The major issues still being discussed include agency relationships, power with less than a majority of the voting rights of an entity, options and convertible instruments to obtain voting rights, disclosures and investment companies. The FASB currently plans to publish an exposure draft at the beginning of the second quarter of 2010. The IASB has tentatively decided that it should publish its final standard after it has considered, with the FASB, comment letters the FASB receives on its proposals. The IASB aims to publish a final standard in the third quarter of 2010. A full project update can be found on the [IASB's website](#). This means that Canadian companies should focus on the current consolidation standard (IAS 27 *Consolidated and Separate Financial Statements* and SIC 12 *Special Purpose Entities*) to assess the IFRS transitional impact since it is unlikely that the revised consolidation standard will be mandatorily applicable in 2011.

Deloitte IFRS publications and events

A comprehensive summary of Deloitte IFRS publications and events is [available here](#).

Please first [login](#), first time visitors will need to complete a short registration form. Below we have included new publications and events most relevant to Canadian companies.

IFRS Publications

20 things to do before 2010 – a practical checklist to keep IFRS conversion on track for 2011.



Webcasts

Archived:

Financial Instruments – On the move again – The Canadian GAAP and IFRS financial instruments standards continue to evolve at an accelerated pace. Join this webcast to learn about recent and proposed amendments to financial instruments standards. Learn what changes will impact current year Canadian GAAP reporting, your opening IFRS balance sheet and post-2009 reporting under Canadian GAAP and/or IFRS. [Click here to see the replay](#).

December 1, 2009:

IFRS and Canadian GAAP technical update – A sea change – The conversion to International Financial Reporting Standards (IFRS) represents a sea change for most publicly accountable entities (PAEs). Chart your course to the finish line with this webcast designed to assist PAEs in understanding the evolving standards and how the changes



will impact an entity's conversion plans. Also, learn about changes to Canadian GAAP that will impact your 2009 financial statements. [Register now!](#)

December 8, 2009:

New GAAP for Private Enterprises or IFRS – Which GAAP will you choose and will you be ready? – Non publicly accountable enterprises and subsidiaries and investees of publicly accountable entities will have a key choice to make. Obtain an overview of the recently approved New GAAP for Private Enterprises, including an IFRS comparison and key business considerations affecting the new reporting framework choice private companies must make soon. [Register now!](#)

December 17, 2009:

U.S. GAAP – Highlights from the AICPA conference – The annual American Institute of Certified Public Accountants (AICPA) National Conference on Current Securities and Exchange Commission ("SEC") and Public Company Accounting Oversight Board ("PCAOB") Developments is scheduled for early December. Register for this webcast to learn about the key issues and debates covered at the AICPA conference, including any progress on debate regarding the SEC Roadmap to IFRS previously issued in 2008. [Register now!](#)

Toronto

December 8-10, 2009:

INFONEX – IFRS Implementation for Energy and Utilities, examining your specific accounting and IFRS implementation strategies for a successful and smooth transition. For more information please [click here](#).

Calgary

December 14, 2009:

Chartered Accountants of Alberta – IFRS: Real Estate. For more information please [click here](#) and search for code 01377.

January 6-7, 2010:

IASeminars – Deloitte IFRS Workshop for Canadian Oil & Gas Entities. For more information please [click here](#).

International Round-up

Updates and news from the IASB

November 4, 2009 IASB amends IAS 24 on related parties

The IASB has revised IAS 24 *Related Party Disclosures* to provide a partial exemption from the disclosure requirements for government-related entities and to clarify the definition of a related party. The Board did not change the fundamental approach to related party disclosures contained in the current version of IAS 24, which requires entities to disclose information about related party relationships and transactions. This revised standard is effective for annual periods beginning on or after January 1, 2011, with earlier application permitted. [Click here](#) for further details.

November 5, 2009 IASB proposes to amend IAS 39 on impairment

The IASB has issued an exposure draft (ED) that proposes to amend IAS 39 *Financial Instruments: Recognition and Measurement* to modify the way impairment losses are recognized on financial assets measured at amortized cost. This is part of the IASB's comprehensive project to replace IAS 39. Under the new 'expected loss model' proposed by the ED, expected losses are recognized throughout the life of a loan or other financial asset measured at amortized cost, not just after a loss event has been identified. Deadline for comments on the ED is June 30, 2010. [Click here](#) for further details.

November 6, 2009 IASB updates its project plan

The IASB revised its work plan for its current best estimate of document publication dates. The Board anticipates the completion of several of its projects in 2010 and 2011. [Click here](#) for further details.

November 12, 2009 IASB issues IFRS 9 Financial Instruments

The IASB issued IFRS 9 *Financial Instruments* as the first step in its project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 introduces new requirements for classifying and measuring financial assets – financial liabilities were excluded from the scope of this standard until the issues related to the impact of non-performance risk in the measurement of liabilities is resolved. The IASB intends to expand IFRS 9 during 2010 to add new requirements for classifying and measuring financial liabilities, derecognition of financial instruments, impairment, and hedge accounting. By the end of 2010, IFRS 9 will be a complete replacement for IAS 39. IFRS 9 is effective for annual reporting periods beginning on or after January 1, 2013, however early adoption is permitted. [Click here](#) for further details.

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