



# Preparing your stakeholders for IFRS

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**CHANGE  
COMING**

# Preparing your stakeholders for IFRS

Many Canadian enterprises are now in the transition year of their move to IFRS. To date, most have been focusing their priorities internally—developing and implementing conversion plans, educating financial staff, addressing the technical and business issues arising, and driving their projects forward.

Adopting IFRS is, of course, intended to make financial results more transparent and comparable for the ultimate users of financial statements. People who have a vested interest in your enterprise's performance—your shareholders, analysts, potential investors, regulators, and lenders—need to understand what reporting your financial information under IFRS will mean for them.

Who should be helping them to develop this understanding? By now, Canadian enterprises recognize that their first financial statements under IFRS will not only look different from their prior Canadian GAAP format, but will also reflect changes in the way results are measured. Each entity is therefore in the best position to educate its external stakeholders, helping them to make sense of what is likely to occur and why, based on its particular circumstances. To date, however, few have deliberately reached out to these external stakeholders.

How can your enterprise work to ensure that your stakeholders will be appropriately prepared for financial reporting under IFRS?

- Recognize the importance of communicating with stakeholders.
- Understand what stakeholders likely know and expect of IFRS.
- Take action! Focus on what your various stakeholders need to understand, issues needing resolution, and providing information at the right time.

## Australian research— IFRS disclosure is critical

Like Canada, Australia is a developed capital market in which equity finance is important, and the standards of regulation and disclosure are relatively high, compared with other countries.

A recent academic research study<sup>1</sup> of 145 large listed companies in Australia points out that “.. our findings are relevant in jurisdictions where IFRS may be adopted in the future, such as Canada ...”.

This study investigated the properties of analyst forecasts from 2001 to 2007 (from four years prior to IFRS adoption to one year post-adoption) and the role of disclosure regarding the financial impact of IFRS. It measured disclosure in two sources—financial statements and earnings guidance.

### Key findings

- In general, analyst forecast accuracy improved significantly over the 2001–2007 period, with one major exception linked to the IFRS changeover.
- **Transition year** (year prior to IFRS adoption)—*Analyst forecast error increased over prior years.* Most companies provided very limited information at the end of the transition year.
- **Adoption year**—*Analyst forecast error declined.* Companies provided more disclosure about IFRS impact during the adoption year.

### Overall conclusions

1. IFRS adoption is a situation where **companies have strong incentives to provide information to analysts** (and the investment community) about the financial impact of IFRS.
2. Those companies providing **higher levels of disclosure** did benefit from **more accurate analyst forecasts**.
3. **Timeliness of disclosures is critical.** *More disclosure in the transition year* about IFRS impact in financial statements would have been beneficial. (The researchers expected that more disclosure about IFRS impact in the transition year would be associated with more accurate analyst forecasts in the adoption year. Australian accounting standards required companies to make mandatory disclosures about adoption of IFRS only at the end of the transition year. Because most Australian companies provided *very limited information* at the *end of the transition year*, these disclosures were limited in their usefulness for analysts.)
4. **Providing both qualitative and quantitative disclosure is important.**

<sup>1</sup> Cotter, J., Tarca, A., Wee, M., 2009, “IFRS adoption and analysts’ earnings forecasts: Australian evidence”, Working Paper, Version 24, August 2009, University of Southern Queensland and University of Western Australia

# Recognizing the importance of communicating with stakeholders

Everyone recognizes that external users of an enterprise's financial information do not like surprises. External stakeholders or financial statement users need to feel confident that your company is not only effectively managing the move to IFRS, but also helping them to anticipate and understand any changes that may arise.

Not providing that assistance increases your potential risk that stakeholders could misunderstand or misinterpret your financial reporting under IFRS, and lead to consequences best avoided. Providing effective and well-timed stakeholder communications should help enterprises to mitigate this risk and minimize undesired consequences.

## Learning from earlier adopters of IFRS

Canadian enterprises are fortunate in that they are able to learn from the experience of not only Australian and European companies that moved to IFRS in 2005, but also Canadian companies that are early adopters. Several companies have obtained permission from Canadian securities regulators to begin reporting in IFRS in 2009 or 2010.

Communicating with external stakeholders, including investors and analysts, is a critical aspect of the changeover that many companies often admit they should have addressed more effectively or sooner. The Australian research study described on the facing page provides objective support for this conclusion.

While this study focuses on analysts, its conclusions also apply to the broader stakeholder community, such as investors, lenders, and regulators. External stakeholders need to be confident in not only the company's IFRS conversion plan, but also their own ability to understand how IFRS will affect the company's financial reporting. Their best source of information is, of course, the company itself.

Canadian enterprises may also benefit from assessing how the Canadian early adopters communicated with stakeholders in both their transition and adoption years. Successful approaches can definitely be replicated by others.



## Canadian regulators' expectations

In articulating their expectations regarding MD&A disclosures<sup>2</sup> for the three years leading up to the changeover date, the Canadian Securities Administrators (CSA) has built on this learning about the importance of stakeholder communications. The CSA

- requires a Canadian issuer to provide investors and other market participants with qualitative disclosures in MD&A
- recognizes that, because IFRS 1 requires disclosure of comparative and reconciliation information in the interim and annual financial statements of the year beginning on an issuer's changeover date, an issuer will need to prepare quantified information about the impact of IFRS on each line item presented in the financial statements for the interim and annual periods of the year preceding changeover
- expects an issuer, for the financial year beginning one year before its changeover date, to disclose available quantified information on the impact of IFRS in its interim and annual MD&A
- encourages an issuer to consider whether additional disclosure beyond MD&A might help inform investors how the issuer expects to be affected by changeover to IFRS.

## OSC wants improved MD&A disclosures

OSC staff undertook a targeted review of the IFRS-related disclosures in issuers' fiscal 2008 and 2009 interim MD&A, observing "... our findings suggest that reporting issuers are not adequately discussing in MD&A the key elements of their IFRS changeover or their progress towards achieving this plan." OSC staff highlight ways to improve future MD&A and provide illustrations of entity-specific disclosures. They remind issuers that "... we will conduct future targeted reviews of issuers' IFRS transition disclosures ... [and] may request re-filings of MD&A ... [or] consider other regulatory action if circumstances warrant."<sup>3</sup>

## Your company's MD&A disclosures

Many Canadian companies may therefore find it useful to consider the perspective of their external stakeholders as they ask themselves the following questions:

- How effective have your company's MD&A disclosures been to date in helping investors and other stakeholders to understand your company's progress and how it will likely be affected by IFRS? Have other companies (competitors, peers or leaders) provided communications that could be perceived as more helpful?
- In the transition year, how should your company be using its MD&A disclosures and other means to provide meaningful information to external stakeholders?
- When should your company be in a position to do so?

<sup>2</sup> CSA Staff Notice 52-320 – Disclosure of Expected Changes in Accounting Policies Relating to Changeover to International Financial Reporting Standards, May 2008

<sup>3</sup> OSC Staff Notice 51-718 – IFRS Transition Disclosure Review, February 2010

## Understanding what stakeholders know and expect of IFRS

To be able to communicate effectively with external stakeholders, each Canadian enterprise needs to understand its stakeholders' information requirements.

What do stakeholders need to understand about IFRS and the impact that IFRS will have on the enterprise's financial reporting? The question, of course, is what these stakeholders currently know, because, to date, many companies have provided only limited information on IFRS.

Analysts are often considered to be a reasonable proxy for the wider investment community. Not only do their reports and recommendations directly influence many investment decisions, but the valuation models and techniques that they deploy are also widely mimicked by other investors. In addition, they can be easily identified, and are usually comfortable sharing their opinions.

To assess the readiness of Canadian capital markets for financial reporting under IFRS, KPMG commissioned a survey of Canadian financial analysts, both buy-side and sell-side. Interviews with 122 analysts were conducted 18 months before the first interim IFRS financial statements will be issued by Canadian companies with December 31 year-ends. This study replicated research undertaken by KPMG in the UK and Australia approximately 15 to 18 months before those countries required initial IFRS financial reporting.



# What do Canadian analysts know about IFRS?

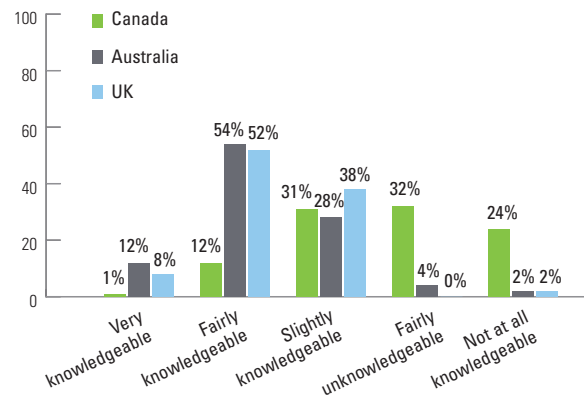


How do Canadian analysts rate their personal level of knowledge of IFRS? These analysts' answers drive home *how little this community currently knows about IFRS*.

In addition, the knowledge levels of these Canadian analysts appear to be much lower than their counterparts in the UK and Australia who participated in similar KPMG surveys conducted 15 and 18 months ahead of those countries' first required IFRS filings. [Q1]

**Q1**

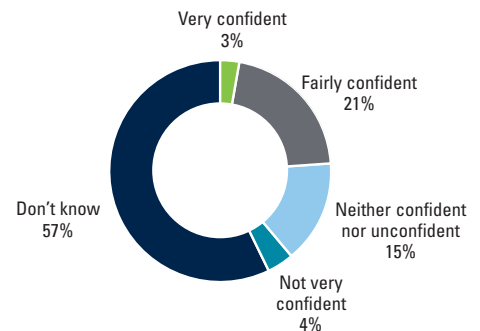
How would you rate your knowledge of IFRS?  
(15 to 18 months before first IFRS financial statements)



Relatively few Canadian analysts express confidence that they understand what the impact of IFRS will be on the companies they invest in or follow. [Q2]

**Q2**

How confident are you that you understand what the impact of IFRS will be on companies you invest in or follow?



## What changes do analysts expect from the move to IFRS?



Analysts who responded that they were “fairly unknowledgeable” or “not at all knowledgeable” about IFRS were not asked further survey questions. For the remaining questions, our findings therefore focus on the 53 analysts whom we refer to as the “knowledgeable” analysts—those indicating that they were very, fairly or slightly knowledgeable about IFRS.

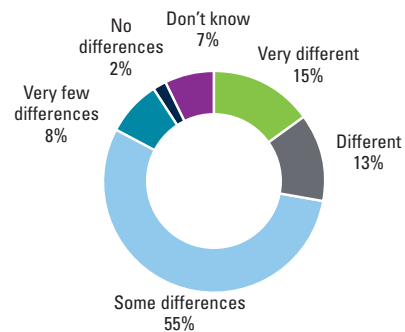
These knowledgeable analysts have different ideas about how much IFRS and Canadian GAAP differ. Of course, some industries will be affected by more IFRS differences than others. Because most analysts focus on specific industries, their responses likely reflect the sectors they follow. [Q3]

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### Q3

How different do you think IFRS is from Canadian GAAP?

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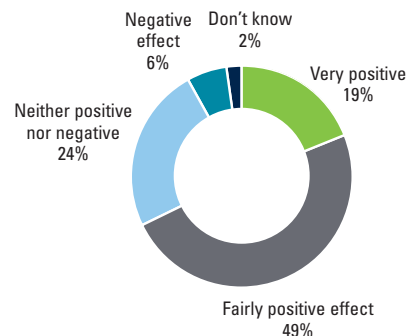
These knowledgeable analysts do have generally positive expectations about how IFRS will affect financial reporting. For example, 7 of 10 analysts believe that IFRS will have a positive impact on transparency of financial reporting [Q4] and reliability of financial statements, and will provide information that investors need to effectively evaluate companies.

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### Q4

How will IFRS affect the transparency in financial reporting?

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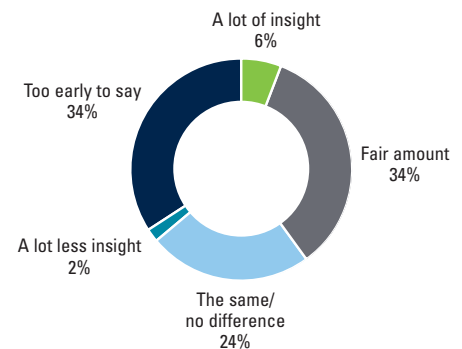


Most (83 percent) of these IFRS-knowledgeable analysts also expect IFRS to have a positive impact on their ability to compare Canadian companies with their global competitors.

They are less certain, however, how much additional insight the introduction of IFRS will give them into the true financial performance of the companies they follow—the majority either expect no difference or feel it is “too early to say.” [Q5]

**Q5**

How much insight into the true financial performance of the companies you follow will the introduction of IFRS give you?

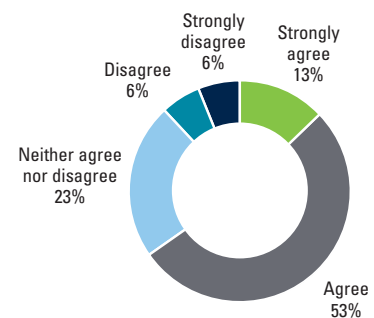


When asked why, those analysts who expect that IFRS will give them insight into companies’ performance highlight the positive contribution of several factors: IFRS increases transparency and disclosure, and, by providing a “level playing field,” it facilitates meaningful comparisons across industries and internationally. Those who feel it is “too early to say” readily admit that they not only still have a lot to learn about IFRS and its impact, but also really need to see the final results.

Overall, many of these analysts believe that the introduction of IFRS will facilitate better investment decision making in capital markets, but—for almost one in four—the jury is still out. [Q6]

**Q6**

In your view, do you agree or disagree the introduction of IFRS will facilitate better investment decision making in capital markets?



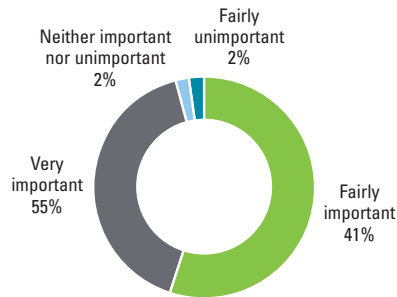


# What do analysts want companies to do? Communicate actively ... and by early 2010!

These IFRS-knowledgeable analysts are almost unanimous in their belief that companies undergoing a transition to IFRS need to communicate actively with the investor/analyst community about their IFRS transition; 55 percent say communication is “very important” and 41 percent say that it is “fairly important.” [Q7]

**Q7**

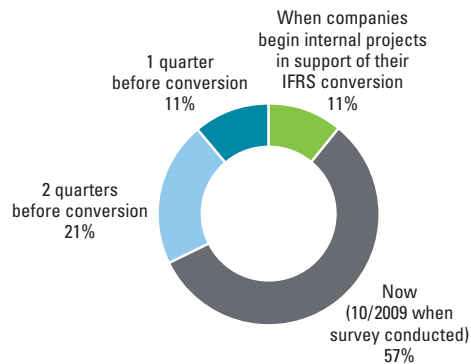
How important is it that companies undergoing a transition to IFRS communicate actively with the investor/analyst community about their IFRS transition?



Canadian companies need to recognize that the majority of analysts believe that companies should have already begun to communicate with the investor/analyst community. [Q8]

**Q8**

How soon should companies begin communicating with the investor/analyst community regarding their IFRS plans?

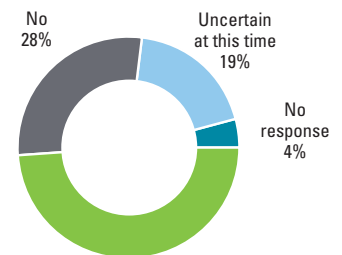


In addition, more than half these analysts indicate that they are *likely to ask companies directly for earnings guidance if it is not provided by early 2010*. [Q9]

Of course, companies should remember that, while analysts are more likely to make a direct approach, the information they seek would also be of value to the company's investors and other stakeholders.

**Q9a**

For companies you follow, are you planning to request earnings guidance that is IFRS-compliant in the period leading up to adoption of IFRS in January 2011?

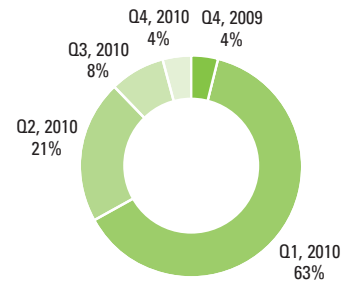


Yes 49%



**Q9b**

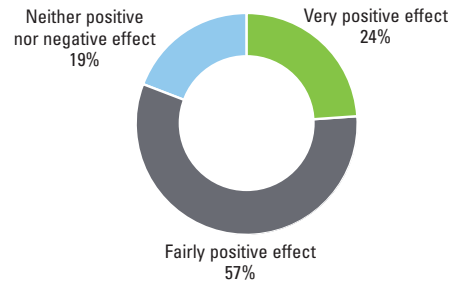
When do you anticipate making such requests?



Proactive and timely communications are likely to be received very positively. [Q10, Q11]

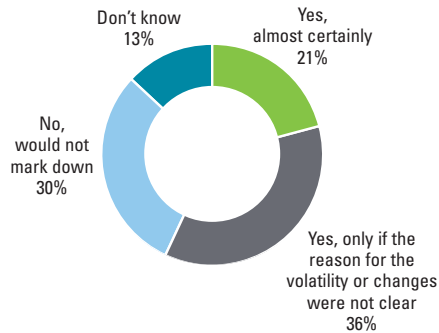
**Q10**

If a company's leadership is open and proactive in communicating with you regarding their IFRS plans and status, what effect would this typically have on your evaluation of the company?



**Q11**

Would you downgrade the shares of a company that showed significant volatility or changes in the numbers it reports after switching to IFRS?



These analysts do make clear the downside to unexpected or unexplained volatility or changes. For companies that do not prepare analysts and investors for potential volatility or changes in reported numbers, the consequences could be dramatic

# What do analysts think of information provided to date?



As noted earlier, the CSA's expectations for IFRS-related disclosures in MD&A encourage Canadian companies to provide the kind of information that will be helpful to the investor/analyst community.

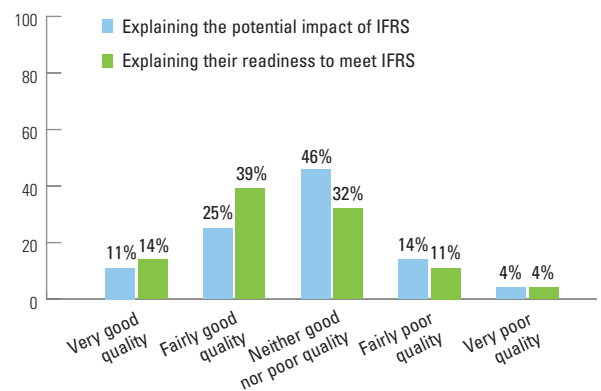
How well have companies' disclosures to date been providing the information analysts require? If these knowledgeable analysts serve as a reliable indicator, many companies still have some distance to go in making informative disclosures.

When asked about the quality of information details that companies were providing (in briefings or in other communications such as MD&A disclosures), these knowledgeable analysts appear to consider companies' explanations of their state of readiness for IFRS slightly more positively than their explanations of the potential impact of IFRS. Overall, however, a significant portion of these analysts describe the IFRS-related disclosures to date as "neither good nor poor quality." [Q12]

**Q12**

Thinking in general about the briefings or details provided, how would you rate the quality of information given in terms of companies explaining

- a) the potential impact of IFRS?
- b) their readiness to meet IFRS?



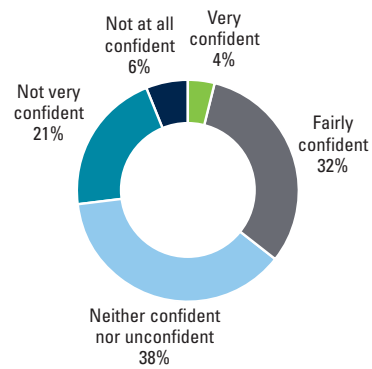
For financial statement users, a major challenge of this move to IFRS will be differentiating, especially in 2011 financial reporting, changes that result from developments in the business from those arising from the use of a new accounting language. When asked to think about the companies that they personally follow, relatively few analysts are confident that they have been given enough information to distinguish the changes in financial reports that will be the result of underlying business performance, and those that will be due to accounting changes under IFRS. [Q13]

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**Q13**

For companies that you personally follow, how confident are you that you have been given enough information to distinguish between changes in financial reports that will be the result of underlying business performance, and those that will be due to accounting changes under IFRS?

.....



Keep in mind that this graph shows the confidence levels of the IFRS-knowledgeable analysts in our survey—nearly 60 percent of the analysts who began the survey had so little knowledge of IFRS that they were not asked most of the survey questions

## How would analysts prefer to learn about changes arising from IFRS?



Those analysts expressing confidence that they could distinguish the source of change were then asked to describe the best way they learned about these changes. Their replies inevitably focused on the specific company as their information source:

- “Communication from the company.”
- “Again, through companies making disclosures on a sporadic basis as that information becomes available.”
- “The companies have been proactive in giving me information.”
- “Speaking with the companies directly.”

If analysts lacked confidence in their ability to distinguish these types of changes, they were asked what information they felt they needed. Again, their replies underscore the importance that a company effectively communicate to improve the understanding of its stakeholders:

- “I think they need to disclose the expected impact well in advance of adopting IFRS.”
- “A walk-through between the old standards and financial statements to the new standards and financial statements, and the factors affecting differences in line items of the financial statements.”
- “Comparative analysis.”
- “The financial report before they change to IFRS and the financial report after they have made their change.”
- “I would like to see a comparison between the financial reports using both standards and explanation of the impact of IFRS going forward.”

These comments, of course, reflect the views of the knowledgeable analysts in the fall of 2009. Their ideas should help enterprises, as they move through the IFRS transition year, to reflect on the kinds of communications that should be helpful to their stakeholders.

## Taking action to educate your stakeholders

Of course, your company's stakeholders represent many more constituencies than analysts, including investors and potential investors, regulators, and lenders.

Our survey clearly demonstrates that the analyst community currently does not have sufficient understanding about IFRS and its impact on financial reporting.

Very likely, most external stakeholders are similarly unprepared. Your enterprise's first financial statements under IFRS will not only look different from their prior Canadian GAAP format, but also reflect changes in the way results are measured. Your company is therefore in the best position to educate your external stakeholders, helping them to make sense of what is likely to occur and why, based on your particular circumstances.

Be sure to anticipate that a major potential difficulty for analysts and investors in 2011, the adoption year for most enterprises, will be being able to distinguish those changes in financial statements that are directly attributable to using a different accounting language from those that reflect differences in underlying business performance. Reduce this potential difficulty by helping your stakeholders, during your 2010 transition year, to understand the IFRS-related changes that will affect your 2011 financial statements.

IFRS therefore presents each enterprise with a major challenge. Obviously, there is no convenient, "one-size-fits-all" approach to this process of education. However, KPMG believes that enterprises can take useful steps, both internally and externally, to educate external stakeholders and manage market perceptions of their financial position and performance under IFRS.



### Recommended internal actions:

- **Ensure that the need for timely and effective stakeholder communications is widely understood** by your board and audit committee, CEO, CFO, and investor relations professionals. Identify which stakeholders are important to your enterprise.
- **Put a high priority on stakeholder communications** and resource it adequately.
- **Carefully evaluate the right timing for your company's stakeholder communications.** In many ways, achieving the right timing is a balancing act. Although analysts may have a thirst for information sooner rather than later, the enterprise needs to be reasonably confident in the completeness and accuracy of the information being disclosed. Stakeholders, especially analysts and lenders, are likely to become much more anxious if companies make disclosures that turn out to be wrong or require subsequent correction.
- **Learn from the experience of Canada's early adopters.** Because some Canadian companies have elected to adopt IFRS in either 2009 or 2010, you can assess their approaches to stakeholder communications, and adopt ideas that are likely to work effectively for your enterprise.
- **Understand any impacts on key performance indicators, including cash flow,** and assess the implications for your enterprise's ability to, for example, pay dividends, meet debt covenants, or address regulatory requirements. Consider the implications for your external communications.
- **Understand whether your enterprise's competitive position might change under IFRS.** Consider whether moving to IFRS will have a positive or negative impact on your enterprise, when compared with its peers. Plan or adjust your communications accordingly.



## Recommended external actions:

- **Reassure investors and other stakeholders that the enterprise is properly prepared to report under IFRS.** For most enterprises, the transition to IFRS is itself a major project. The consequences of getting it wrong are potentially serious. Explain progress on resolving key accounting and reporting issues, the effect on systems and processes, resource and training issues, and other business considerations.
- **Focus on the issues the markets want to know about and need to understand.**
  - In communicating how IFRS affects your financial reporting, consider separating out those that represent simply presentational changes under IFRS (with no resulting impact on net earnings) from those representing recognition and measurement differences. Analysts and investors will find it extremely difficult, if not impossible, to sort these things out without your company's help.
  - Explaining key aspects of your 2010 opening balance sheet and quarterly financial statements, restated in IFRS from Canadian GAAP, will help stakeholders to isolate the effect of changing the accounting language to IFRS.
  - Then, when reporting under IFRS in 2011, explain what movements in financial information reflect IFRS-related accounting changes, and those that result from changes in underlying business performance.
- **Leverage the CSA's expectations for MD&A disclosures to help shareholders and the investment community** to understand your company's circumstances.
  - Provide disclosures that, as noted above, enable them to understand and be confident in your conversion process.
  - By providing qualitative *and* quantitative information, assist them in understanding the likely impact on your financial statements and performance measures.
  - Consider supplementing the MD&A disclosures with additional information that further contributes to investors' understanding.
- **Place IFRS effects in their proper context.** Individual standards will raise significant issues for some enterprises, while others may have minimal effect. Even if the net bottom-line impact of a particular IFRS-related change is negligible, explaining why this is the case can help to build confidence in the rigour your enterprise is applying.
- **Cover all the bases**, including the status of standards, the assumptions used in determining accounting impacts and other effects on the business, the revised accounting policies and IFRS 1 *First-time adoption of IFRS* transition elections used, and the consequences for key performance measures.

## Focus on what's right ... for your company and your stakeholders

Remember, the process of educating stakeholders about IFRS, particularly in the transition year, will likely prove to be challenging. For many enterprises, it will require a fine balance—management's comfort with the accuracy and completeness of information versus stakeholders' requests for information sooner rather than later. Your process may potentially be complicated by competitors that make information available before your company planned to do so. Anticipate that you will be applying careful judgment and may be consulting regularly with securities counsel.

Recognize that, in practice, this education or communication process may vary widely for different entities. Enterprises are moving through their IFRS projects at different rates, often because of particular project issues and management's ability to close those issues, but sometimes because of pending requirements that only time can resolve.

Despite such challenges, continue to *think about the move to IFRS from the perspective of your external stakeholders*. They need to learn, and your enterprise is in the best position to help them to make sense of what is likely to occur and why, based on your particular circumstances. As our survey of analysts suggests, communications that are proactive, informative, and timely are likely to be received very positively.

And one final suggestion: use your enterprise's transition to IFRS to enhance ongoing stakeholder communication, rather than treating it as a one-off exercise. In other words, use IFRS as an opportunity to review and improve your enterprise's overall approach to communicating with investors, analysts, and other important stakeholder groups.



## Contact us

If you have questions or issues you would like to discuss, please get in touch with a member of your KPMG engagement team or one of our IFRS professionals, some of whom are listed below. Visit our Web site, [www.kpmg.ca/ifrs](http://www.kpmg.ca/ifrs), for easy access to KPMG's IFRS publications and other materials.

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