



## Keeping your banker happy: The bottom line is communication

By Brahm Rosen

It's 10 a.m. when Roger Brown, president of Brown Inc., receives a telephone call from his largest supplier advising him that Brown's cheque has bounced, and until it is replaced the supplier will be holding further shipments. Later, as Brown tries to remedy the problem, he angrily tells his controller, "the bank is ruining me! Don't they understand my business? How could they do this without calling me?"

At the same time in a downtown bank tower, Brown Inc.'s account manager is discussing the account with a colleague. "I can't believe Brown. They are constantly over their credit line. We have written them continuously about managing cash flow; maybe now they will get the message."

This type of situation arises often between banks and its customers. Could it have been avoided? Yes! While companies may not be able to eliminate financial difficulties and differences of opinion with its bankers, they do not need to get into situa-



Timely communication can help a company maintain favourable relations with its bank.

tions like this one.

Sensible business practices can help a company maintain favourable relations with its bank. Surprisingly, these practices are often ignored or only partially adhered to. While some of these practices are particularly helpful when a company is facing a financial crisis, they are all generally relevant even to the healthiest of companies.

*(Continued on page 3)*

### Inside this issue:

Investing in public companies: Operating cash flow	2
Be careful out there: Government auditors on the net	2
Ontario tax installments	4

## GST/HST rate reduction

By Doug Robinson

Effective January 1, 2008, the rates of the GST and the HST will be reduced. The rate of the GST will be reduced from 6% to 5%. The rate of the HST will be reduced from 14% to 13%.

Generally, the new rates of tax apply to the supply of taxable (other than zero-rated) goods and services in the following circum-

stances:

- If the GST/HST becomes **payable** on or after January 1, 2008, without having been paid before that day, the rate of 5% GST or 13% HST will apply.
- If the GST/HST is **paid** on or after January 1, 2008, without having become payable before that day, the rate of 5% GST or 13% HST will apply.

*(Continued on page 4)*



## Be careful out there: Government auditors on the net

By Doug Robinson

In the 1980s TV cop show, "Hill Street Blues", Sergeant Phil Esterhaus concluded the morning roll call at the start of each show with the catch phrase "Hey, let's be careful out there". This phrase has become particularly meaningful today with respect to company websites.

The internet has provided a tremendous opportunity for companies to promote their businesses. From international mega companies to small work-from-home businesses the internet has become part of the accepted marketing approach needed to survive in business. Companies of all sizes have seized

*Companies found information posted on their website used against them by government auditors*

upon the opportunities their website provides to assist in achieving various marketing, promotional and sales objectives. The use of third-party websites to promote the business has also become quite common place. However this very public information exchange can also have its drawbacks. It is now fairly standard practice for government auditors in all agencies to use the internet to re-search the prospective audit target in much the same way that a prospective employee, supplier or customer might also do a background check. There has been an increase in the number of cases where companies have found

that the information they posted on their website has been used against them by government auditors. One company found itself audited for PST because of information on its website. Another company found itself dealing with issues related to uncollected GST because of its website. Many companies have boasted of their performance on their websites only to find that the CRA auditors are fully conversant with these boasts.

There is an old saying that goes "Dance like no one's watching". If you use this approach to your website you may find you have unwanted guests. It is far safer to assume that a government auditor is reading every word you put on your website.

You may dance like no one's watching but ... hey, let's be careful out there.

## Investing in public companies: Consider operating cash flow

*Guest column*

Most stock market analysts use earnings-based estimates as the primary basis for valuation. Variations on this approach are found in many research companies' reports.

I believe that an alternative method can give a better indication of value - Operating Cash Flow ("OCF").

Cash flow from operations is a line item in the "sources and uses of funds" statement (one of the financial statements). It is a good indicator of how a company is performing, by showing the cash generated by the products and services a company sells.

In simple terms, OCF can be defined as the actual cash that a company is generating. OCF is a company's financial lifeblood. A sudden reduction can drain this lifeblood, causing an increase in debt, share dilution, share price erosion and in more extreme cases, bankruptcy

OCF is very difficult to manipulate through choices of accounting policies, in comparison to net income (Earnings Per

Share, or EPS). There are significant differences among industries and companies in the timing and recognition of revenue, deferred taxation, pension liabilities, methods of depreciation and amortization. Consequently, net income can differ between similar companies solely as a result of accounting policies. These differences often affect how analysts estimate stock values. So how can the investor really know what value they are acquiring?

OCF-based stock valuation is used largely by institutional portfolio managers and corporate finance departments as a main metric in understanding company cash valuations. Many forms of retail research do not stress Operating Cash Flow since earnings approaches may make it easier to compare different companies. As a result, OCF is a reliable indicator of share price value while, in my opinion, EPS indicators are less reliable.

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**Valuation: cash flow or earnings approach?**

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(Continued from page 1)

### Timely Monthly Reporting

Banking agreements typically include a provision requiring the business customer to provide monthly financial information within a prescribed time after the end of the month, usually including financial statements, a listing of accounts receivable and monthly margin positions. Be sure to provide this information to your bank on time. If it is going to be late, call your banker and advise him before the deadline. Very likely you will be granted an extension.

The implications of not providing timely information include the following:

- Creating more work for your account manager in his monthly reporting. Remember that your account manager has a large portfolio. Making his work easier has its advantages.
- Creating a possible perception that the company has financial problems, even if it does not.
- Creating a negative impression of the company and management.

### Open Lines of Communication

It is critical to maintain open lines of communication with your banker. If a major negative event takes place in your business, inform your banker preferably *before* the event.

If, for instance, your company requires a temporary bulge in its line of credit, perhaps to purchase inventory at favourable prices or to complete a profitable contract, call your bank and set out your borrowing requirements. If the terms are reasonable, the bank will likely support you. If you attempt to exceed your credit line without informing your bank and expect the bank to simply tolerate the overage, more likely than not you will end up in Mr. Brown's situation.

Establishing and maintaining good lines of communication will assist in developing a sense of trust and loyalty between your company and its bankers, which will benefit future relations.

### Preparation of Realistic Business Plans

If your bank asks you to submit an annual business plan, prepare the plan on a realistic basis, thoughtfully considering all elements and assumptions. The bank will use the plan as a benchmark to monitor results. Significant deviations from the plan will raise questions about the company's operations and management.

Bankers often receive plans that show only the best case scenario (e.g. significant sales increase, large profits and reductions in company borrowings). When the projected results do not materialize, management is often surprised by the banker's disappointment and reluctance to support future activities and projects.

It is therefore important to provide a realistic, reliable plan to your banker. Giving the bank "what they want" does not mean projecting unachievable targets. If circumstances permit, you might set out two scenarios, "best case" and "realistic case", rather than submit a single scenario that has little chance of succeeding.

### If in Difficulty, Call Quickly

If your company begins experiencing financial difficulty, communications with your bank will become even more critical. It is advantageous to call your banker before he calls you.

You should immediately arrange a meeting with your banker, and arrive armed with an analysis of the cause of your difficulties and your plan for dealing with them. Remember that your bank is usually your largest creditor and effectively a partner in your business; therefore, your banker has a significant interest in assisting your company. The opportunity to turn your company around will be greatly enhanced if your banker is a supporter rather than an adversary.

The common thread of the issues discussed above is communication, written or verbal, routine or unusual. Timely communication with your banker will create an atmosphere of trust and loyalty, which will usually lead to a strong working relationship.

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*If reporting is going to be late, call your banker. Very likely you will be granted an extension.*



**Remember that your bank is a partner in your business**



## No Ontario tax installments in 2008

By Doug Robinson

If your corporation has been paying regular tax instalments to both Ontario and the Federal government you will notice a change beginning in February 2008. You will only have to pay the instalments to the Federal government. This is not a tax savings. The amount you pay will be the same as if you had to remit to both governments but you will only have to pay it to one source.

Effective January 1, 2009 the Canada Revenue Agency ("CRA") is taking over responsibility for Ontario's corporation income tax. As part of the transitional procedures the CRA will start collecting Ontario instalments for 2008.

A single tax return covering both Ontario and Federal income taxes will follow in 2009 for tax years ending after December 31, 2008.

These changes are the result of a harmonization agreement that the Governments of Canada and Ontario signed on October 6, 2006. The single administration of Ontario's corporate tax by the CRA will lead to one set of rules, one form, one audit, one appeals process and one point of contact.

There are transitional rules that will bring any prior differences between Ontario tax balances and the Federal tax balances into agreement over a five year transitional period. If you need details as to how these transitional rules will apply in your particular situation please contact your SF representative.



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## GST/HST rate reduction

(Continued from page 1)

- If the GST/HST becomes payable or is paid without having become payable before January 1, 2008, the rate of 6% GST or 14% HST will continue to apply.

Two examples may help to clarify these rules.

*A business invoiced a customer before January 1, 2008, for the sale of goods in Ontario. The customer paid the invoice after January 1, 2008. Since the GST became payable on the date of the invoice, which was before January 1, 2008, the business would charge the customer the GST at the rate of 6%.*

*An engineer in the normal course of business will be issuing an invoice after January 1, 2008, for services performed in Manitoba before January 1, 2008. The client has not paid the engineer before invoicing. Since the engineer will issue the invoice after January 1, 2008, the engineer would charge the GST at the rate of 5% on these services.*

The rules that normally determine when the GST/HST is payable will continue to apply to determine the appropriate rate of tax for deposits. A deposit is not treated as a payment for a supply until such time as the supplier applies it against the amount payable for the supply.

*In November 2007, a person gave a deposit of \$100 for the services of an artist. The artist invoices the person after January 1, 2008 for her services. The GST or HST will not apply to the \$100 deposit until such time as the artist applies it against the amount payable for her services. Since this occurs after January 1, 2008, the GST at the rate of 5%, or the HST at the rate of 13%, will apply at that time on the amount payable for the services.*

There are detailed rules covering real estate transactions, allowances and reimbursements that are beyond the scope of this particular communication. In addition, there are a variety of anti-avoidance rules that are also beyond the scope of this communication. If you have detailed questions regarding how the GST/HST rate change will affect your particular business please talk to your SF representative.