

Canadian tire audit report



Client risk profile Canadian Tire Corporation, Limited (CT) is primarily a Canadian retailer, focusing on automotive and general merchandise. Founded in 1922, the company has been around for almost a century, building strong brand recognition in Canada. Initially starting as a car parts retailer they have expanded rapidly into other areas, mainly general merchandise retail. They have other secondary divisions being; Apparatuses Automotive stores (strictly automotive parts), Financial Services, Marks Work Warehouse (clothing retailer), FIG Sports Ltd. Various sporting good retail chains), ND Canadian Tire Petroleum (gas stations and car washing). The main users of Sect's financial statements have been identified as the debt holders and shareholders. Industry There are many external factors affecting Canadian Tire Corporation (CITE: EXHIBIT 1). As the largest business divisions, the major external forces impacting the Retail and Financial Services divisions are listed below. Economic Forces Canadian unemployment is a good indicator of consumers' willingness to spend. Currently unemployment is trending upwards (CITE: EXHIBIT 3).

This is poor for the detail industry as consumer spending will decrease as unemployment increases. It impacts all of Sect's divisions. Volatile Petroleum Costs Crude oil prices have been extremely volatile lately (CITE FIGURE Z). This has an impact on the supply chain of retailers, as transportation costs will increase with increased fuel costs. This also heavily impacts the Petroleum division because the cost of acquiring crude oil is difficult to anticipate. Competition The retail space is extremely competitive in Canada. Some major competitors have been identified and can be found in (CITE: exhibit 2).

It is important to be aware of Sect's strategy and its goals of staying competitive. There is a trend of US retailers moving into Canada, such as Target. Seasonality Both the Retail and Petroleum divisions are highly seasonal. Consumer demand in both industries fluctuate throughout the holiday seasons, and are significantly impacted by the weather. Key Success Factors As ten implant Loves, ten Key success Tattoos we have lament industry are as follows: 1. Maintaining low costs nee Tort ten retail 2. Managing inventory to successfully anticipate and meet consumer demand 3.

Establishing brand loyalty 4. Quality products Competitors must trade off these Skiffs to succeed, it is extremely difficult to employ all together (CITE: EXHIBIT 5). For example, in order to have superior customer service they need to hire more staff and this will increase costs. CT needs to focus on a specific strategy, as it is extremely difficult to have all SF maximized.

Business & Operations Internal Sect's major sources of revenue comes from its retail and petroleum divisions (55. 85% & 19. 07% of 2011 revenue). They are dependent on this revenue and need to keep customers happy to maintain it.

CT is one of the largest retailers in Canada. This gives them bargaining power with suppliers. If current suppliers threaten to unfavorable change terms or stop supply, CT can find replacement suppliers. CT has a diverse product offering. They are not dependent on any one product for revenue.

Operational/reporting structure Canadian Tire Corporation is responsible for the centralized accounting and financial planning functions. Wholly-owned

subsidiaries manage their own operations and accounting, with the exception of the consolidated financial information.

The Retail and Financial Services divisions have been classified as strategic business units, Hereford both are reportable operating segments. Due to the inherent difference in the nature of their businesses, they are both separately managed. With regards to Retail and Financial Services, all financial information, including adjustments and eliminations, are presented clearly in consolidated financial statements. CT applies a dealer-corporation business model to its Retail operations. Each store is franchised with the owner being a ‘dealer’.

This system causes many inefficiencies, both financial and non-financial, for CTR in comparison to its competitors (EXHIBIT CUBIC REPORT). However, the dealer-corporation model is as old as Canadian Tire itself and extremely unlikely to change. Essentially the dealer is responsible for everything in-store, and the corporation takes care of the rest. A list of segregated responsibilities can be seen in Exhibit Z. Going Concern Canadian Tire Corporation is in good financial standing and extremely unlikely to bankrupt in coming years. Currently Sect’s debt to equity ratio is 0.42 below the industry average of 1.557, with a current ratio 0.614 above the industry average of 1.061. Addressing the debt to equity shortfall, CT has decreased its debt to equity from 1.897 to 1.739 between third quarters of 2012 and 2010. This is including the acquisition of FIG Sports Ltd. Which spiked debt in 2011. (CITE ANALYTICAL s) I nerve Is no Issue AT going concern. Technology IT is centrally-managed for each of Sect’s specific divisions. Retail stores use software to keep track of inventory and prices regarding items in stores.

The stores then transmit this information to make purchases from CT. It is an integral part of their supply chain and retail operations. They are continuing to upgrade these internally developed systems, which could pose a risk for exceptions. These systems will require increased test of controls before we can assess their reliability. However, with Financial Services, a vast majority of the data is outsourced to Axiom for warehousing and analysis, and to Total Related Parties for transaction processing. Related parties Ms. Martha G. Bibles is a major shareholder, controlling 61% of common shares.

Related-party relationships exist between members of the Board of Directors, the CEO and SCOFF, top five officers, and entities which they exercise control over. Their family members are also related-parties. There are transactions between CT and lealer that are members of the Board of Directors totaled less than 1% of 2011 total revenue. The recording of these transactions must follow FIRS for the fair presentation of reported income.

Wholly-owned subsidiaries of the Canadian Tire Corporation include Canadian Tire Financial Services Limited, Marks Work Warehouse Ltd. , Canadian Tire Real Estate Limited, and FIG Sports Ltd.

The consolidated financial statements of CT include the statements of these subsidiaries. Management/Governance Code of ethics CT has subscribed to a code of conduct that describes how management should CT responsibly and ethically. There have not been any notable infractions or revisions recently. The code of conduct is publicly available, along with a a website and hotlist for weightlessness to report violations. Corporate Governance There is a positive tone set by the Board of Directors and upper management in directing the company through its business operations.

That large majority of directors are independent, with the exceptions being the CEO and three dealers. Many board members have past experience with large public corporations and are currently involved in charitable initiatives. The extensive amount of dealer-related committees (CITE CUBIC REPORT) and board committees, while inefficient, demonstrates that any concern between Canadian Tire dealers and the corporation can be managed by knowledgeable and experienced parties. We believe the governance exercised over the corporation adds positive value. Intercrop. Centrally. Ca/EN/loneliness romance/Documents/ CT_Governance_2012_Eng. UDF Client Objectives and Strategies CT has clearly defined vision and mission statements (CITE: exhibit X). This demonstrates the conscious existence of long term goals and strategies. In addition o these qualitative objectives there are also have several quantitative ones (CITE: exhibit X), which are paired with specific strategies to achieve them. For example, under their second goal, aligning all business units to the core, they want to “ Drive growth in the Retail segment with the integration and development of FIG Sports”. This can be measured with sales growth. These goals seem reasonable and achievable.

There is no undue pressure on management to meet unreasonably high goals. Reliability of Financial Reporting CT has strong quality of earnings. There have been no major restatements in recent years. Their financial reporting methods are reliable. Effectiveness and Efficiency of Operations Due to the nature of the ‘ pull’ system of the Dealer-corporation relationship of Canadian Tire Retail, the implications for the entire company are significant. In our view, the most meaningful is significant inefficiency in the

supply chain, in the form of elevated inventory and extraneous resources given to forecasting and replenishment.

While head office can be quite accurate with its prediction on consumer demand for a product when it goes on sale, that is not actually the relevant exercise. Rather, it needs to forecast dealer demand. Understandably, it is much more difficult to reliably estimate just how much the dealer network will order, which can be something entirely different from consumer demand. The inventory is Dealer- managed while distribution is Corporation-managed there is a large inefficiency regarding the distribution process.

The Corporation is faced with an ongoing challenge of meeting dealer demand, therefore logistical planning must be flexible and in turn less efficient. This relationship is as old as Canadian Tire itself, a crucial aspect of the corporate culture, and any significant change is unlikely. When acquiring FIG Sports Ltd. In 2011, \$308. 1 million was allocated to Goodwill during the transaction (not to be amortized). The majority of this results from expected future growth potential of the expanded customer of FIG Sports Ltd. CT may feel pressure from investors regarding the success of FIG in 2012, and the combination as a whole.

Compliance with Laws and Regulations CT is fully compliant with Canadian laws and regulations. They even go above and beyond an example of this is their recent voluntary recall of a blender that did not meet environmental standards. (CITE: [http://www. Newswire. Ca/en/story/1048487/](http://www.Newswire.Ca/en/story/1048487/) Indian-tire-voluntarily-recalls-gas-powered-blender-31) overall R Inherent Risk Overall inherent risk is low. Canadian Tire Corporation is an established public

corporation with many successful previous audits. They subscribe to proper accounting procedures and have an experienced management team with strong integrity.

It is a repeat engagement and this lowers risk factor as well. Cycle specific risk is broken down in (CITE: exhibit 6). The biggest risks are in the sales/collection, acquisition/payment and inventory/warehousing. Sales and inventory risk are both related revenue recognition with the dealer model CT adheres to. There is potential for sales and inventory to be overstated or understated as a result of transactional cut off errors. The audit objectives affected by this are occurrence, completeness, timing and cut-off. The acquisition cycle risk comes from Sect's recent acquisition of FIG.

There are valuation risks as well as other possible risks relating to the integrity of Gel's past financial information. This affects the valuation audit objective. The largest issue affecting inherent risk is the internally-developed software implemented throughout retail locations. Internally-developed software is naturally seen as less reliable than externally-developed, and must be tested heavily before it is deemed reliable. We believe that these inherent risks have been properly identified and addressed, and do not exceed a ' low risk assessment. Control Risk Control risk is medium.

Management is responsible for the creation of and maintaining a system of controls and procedures regarding public disclosure of all financial and non-financial information pertaining to Canadian Tire. A set of internal controls over financial reporting are designed to provide the reasonable assurance of timely and accurate financial information. As mentioned in the 2011 Annual

Report, management feels confident that internal controls over financial reporting are effective (SEE EXHIBIT). The major control risk issue is the acquisition of FIG Sports and its subsidiaries on August 11, 2011.

A scope limitation results from the extended time required to assess FIG Sports' disclosure controls, procedures, and internal controls over financial reporting consistently with Act's operations. There has been the only recent change in Act's internal control over financial reporting " that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting". Detection Risk Detection risk is low. We are a reliable international public accounting/consulting firm and are confident in our audit procedures.

We have audited Canadian Tire Corporation numerous times in the past. We are confident that we will not fail in detecting any material misstatements relating to an assertion in the consolidated financial statements for the year ended December 29, 2012. Audit Risk Allot rolls is low. C is a public corporation, whose Atlanta statements have a broad range of users. This increases the audit risk. CT is financially strong, maintaining very little risk of financial failure (CITE: ANALYTICAL PROCEDURE), lowering audit risk.

The executive management team is a wide and diverse group with a proven track record of working for various public companies (IEEE. Bell-Lillian). In addition to these experiences many are involved with not-for-profit organizations. For example, Duncan Fulton is involved with One X One that does work in Africa. The integrity shown by upper management sets a reliable and trustworthy tone-at-the-top. As a combination of low risk

regarding Sect's reliable financial information, and our confident skills as auditors, we believe there is low risk in issuing an incorrect audit opinion.

As a result, increased evidence must be collected to support our opinion. Materiality Materiality will be set at \$60, 000. This was decided based on using the rounded average of materiality for 2011 & 2010. The materiality for each year was based on an average of percentages of net income before taxes, gross profit, total assets, shareholders equity and revenue. The percentages of each item were selected in the middle range. We believe it is important to use all five to more successfully capture Sect's diverse business operations.

For income based materiality calculations rental revenue was removed since it is not a part of Canadian Tire's primary business. It could be argued that a \$60, 000 level of materiality may be too low, however we strongly believe it is appropriate given our method, and provide the best opportunity to detect impact misstatements. All calculations can be found in Exhibit X. Key Audit Issues Issue – Adjusting Entries There are various adjustment entries that are made when preparing consolidated financial statements for a large corporation.

These entries are always a noteworthy issue because they are abnormal. Some large adjustments that are consistently made are interception revenue adjustments relating to the Retail and Financial Services divisions. These are of particular importance because their amounts can materially impact the entire financial statements. Unexpected adjustments may be made by management, which cycle can not be anticipated now. We must inspect the

nature of each adjusting entry, to assure they occur to fairly represent Sect's business operations in accordance with ' FRR. Issue – FIG Sports Ltd. S Internal controls Canadian Tire Corporation has not fully assessed FIG Sports Ltd. ' s disclosure intros, procedures, and internal controls over financial reporting for a level of consistency with Canadian Tire's operations. Although FIG has reported publicly in prior years regarding ten quality AT Internal controls, slice calculation, Is not capable of giving a similar opinion at this time. This issue will affect all audit cycles surrounding FIG Sports Ltd. Naturally we must spend more time testing the internal controls of FIG in comparison to other CT divisions.

The level of substantive testing will be decided upon depending on our assessment of the reliability of their internal controls and procedures. Fag's internal controls must be rigorously tested to determine their reliability. This is preferred over increased substantive testing because Fag's controls will be a part of future audits. Issue – Revenue Recognition Recognition and reporting of revenue is a major issue because shipments made through the retail division are by far the largest contributor to CT revenue, and extremely material.

This issue pertains to the sales and collection, and inventory and warehousing cycles, with the timing of sales transactions and cut off of inventory balances particularly important. We must be present at the year end inventory mount, as well as match shipping documents to sales invoices directly before and after the cut off, to ensure all of, and only the correct revenue is recognized. Issue – Meeting Investor Expectations of Efficiency

Investors are aware of Canadian Tire Retail's dealer-corporation model, its inefficiencies, and expect change.

The CUBIC Institutional Equity Research Report regarding Canadian Tire Corporation, issued October 9, 2012, is a prime example of this. It is clear that at least one institution has identified an estimated \$500, 000, 000 efficiency gap between CTR and its competitors, and have set expectations to close that gap partially, if not entirely. If Canadian Tire is not able to streamline operations to eliminate its competitive inefficiency, management may feel pressured to misstate the SO&A expenses of the Retail division.

The transaction-related, and presentation and disclosure audit objectives of most importance to this issue are completeness and accuracy. This issue impacts the acquisition and payment, and personnel and payroll cycles as SO&A expenses can be related to both employees and external parties. Increased substantive testing of SO&A-related expenses accounts at random intervals before year end to obtain a more reliable sample of transactions. (CITE: CUBIC REPORT) Issue - Accounting Estimates CT estimates some of the amounts on the consolidated financial statements using complex financial models.

They do this for loan impairment losses, which is a material amount CITE # from Income Statement. Loan impairment losses would be part of the acquisition and payment cycle as it relates to accounts payable. It will be important to review their methodology in calculating this and compare the actual results with prior years to find any exceptions. Issue - Lawsuits CT has several outstanding lawsuits. Many are routine, however there are some

larger ones Walt tenet Dankly Loves. I nose relate to ten calculation Ana payment cycle because if they lose, a payment must be made on behalf of CT.

If CT were to lose these lawsuits there would be a charge of roughly \$25,000,000. This is extremely material. The cases need to be carefully inspected and assessed to determine the probable outcome. Issue - Inventory Turnover Sect's inventory turnover rate has decreased from 3.405/year to 3.185/year (CITE ratios). This relates directly to the inventory and warehousing cycle because CT is loading inventory, on average, for longer. One possible reason is the poor retail sales last winter, resulting in excess inventory of snow-related products.

Sect's inventory account is quite large, an issue of obsolescence is material. An inventory inspection must be conducted to test the obsolescence of ending inventory. Issue - Maturing Glacier Debt The maturing (February 2013) debt obligations of Glacier amounting to \$634.9 million (CITE Q earnings report) leads to an issue of cash accumulation for Canadian Tire Corporation. Cash and cash equivalents of Q 2011 was significantly higher than Q 2012, to fund Glacier's maturing debt obligations of November 2011.

It is likely that throughout Q 2012 and January 2013 CT will accumulate cash again to fund the maturing debt. This issue applies to the sales and collection cycle, specifically pertaining to the timing of collection transactions in the 2012 year and the cash balance at the 2012 fiscal year cut-off. Increased transaction around this time to accumulate greater cash can cause misstatements or errors to be more likely. This issue is highly

material due to the amount of maturing debt, and cash that must be raised. We must increase substantive testing of cash and collection accounts near, at, and after year end.

EXHIBITS exhibit 1 – external forces External Force Implication Impact (+/-)
 Monetary policies Have a direct impact on economy/consumers Consumer protection Increasing regulation leading to higher costs Employment laws Changing laws, more costs to comply Economic growth Recession, consumers will spend less Consumer confidence Relatively stable, consumers will spend more New technologies Can manage inventory better, lower costs Lots of competition Volatile fuel costs Can raise or lower costs +1- Change in accounting rules

How to value inventory/reserves Must successfully anticipate and meet changing seasonal demand +1- exhibit 2 – Act's Competitors Competitor Threat Level? Walter direct Cost Home Hardware Rona Home Depot Target (soon) Nap Auto Parts Princess Auto mildly- Canaan unemployment Year chart *taken from stance Exhibit 6 – Inherent Risk Cycle Specific Cycle Inherent Risk Level Reasoning/ Implication Sales/Collection Medium Shipped goods to dealers recorded as revenue before final sale to end consumer. Poses revenue recognition issues. Could potentially inflate revenue by pushing inventory down to dealers.

Implication being need to spend more time looking at revenue account. Personnel/Payroll Low No foreseeable issues for this cycle. Less time can be spent on related accounts. Acquisition/Payment New acquisition of Fortran group; how to implement them into CT, could be hidden fraud within

them???? Inventory/Warehousing Tied in with reasoning for sales/collection
IEEE. Dealer relationship Capital Acquisition/ Repayment Exhibit (control risk)
“ As required by IN 52-109, management, including the CEO and SCOFF,
evaluated the design and effectiveness of our internal control over financial
reporting as defined in