



FINANCIAL REPORTING CONSIDERATIONS

We have prepared a brief summary of financial reporting, technology and other considerations that we believe may be of interest to you in operating a retail business in Canada.

Cunningham LLP has extensive experience with retail operations in Canada, which includes several apparel retailers. We would therefore like to take this opportunity to highlight several matters in this letter that we believe are of significance to you at this stage in your operations.

The Canadian Institute of Chartered Accountants (the "CICA") dictates that entities reporting in Canada must conform to Canadian General Accepted Accounting Principles ("GAAP"), except in limited cases. Below, we have provided a summary of several key accounting issues that may impact your entity. However, please note that the ultimate treatment of an accounting issue will depend on the specific facts and circumstances of the case and typically will require the professional judgment of an accountant.

We would be more than pleased to discuss these and other accounting matters with you in more detail at your convenience.

1. Start-up Costs

Costs incurred by the entity prior to its first set of stores becoming operational and generating revenue, can typically be deferred and amortized over a period of up to five years as long as certain criteria are met. Costs incurred for additional store openings are generally expensed as incurred.

2. Leasehold Inducements

Typically, leasehold inducements are accounted for in accordance with the purpose of the inducement. For example, three months free rent given by a lessor is accounted for by as a reduction of the rental expense and amortized over the term of the lease.

3. Revenue Recognition

a. Initial Recognition

Generally, GAAP dictates that revenue be recognized at the time the transaction is entered into at the point-of-sale register (“POS system”), net of returns. This does not typically pose a reporting risk for retailers, except in rare cases in which the POS systems do not operate in accordance with the initial code set up by the software developer or in the case that district managers manipulate operating results to improve their incentives.

b. Provision for Returns

A provision for returns may be difficult for management to estimate, especially in the first several years of operation where there is little or no return history. GAAP requires management to make reasonable assumptions with regard to the provision for returns.

c. Gift Certificates and Gift Cards

The accounting for gift certificates and gift cards is usually a difficult area for entities in the retail sector given that management is required to make significant assumptions and estimates. Generally, the cash received on the purchase of gift certificates or gift cards would be deferred and recognized into revenue at the later of 1) the redemption of the gift card, or 2) the expiration of the gift card.

Alternatively, recognizing the margin and/or historical redemption rates maybe another consideration. Typically, a POS system will provide sufficient information to assess the number of unredeemed gift cards, however, in the case that this information is not readily available, management would make a reasonable estimate.

4. Inventory

GAAP requires that inventory be recorded at the lower of cost and net realizable value with cost being determined on the weighted average basis. However, we understand that in the retail industry, entities may choose to adopt the retail method of accounting for inventory and as such; we support this method of accounting for inventory given that it is also in accordance with GAAP. Inventory obsolescence, inventory costing and inventory consignment are several of the key accounting issues facing retailers.

Typically, a strong POS system can provide relevant information with regards to costing and valuation of inventory, especially during period end inventory counts conducted by management. POS systems that do not provide information of this nature may require management to complete additional analysis on inventory trends, in order ensure that there is a sufficient provision for obsolescence.

TECHNOLOGY CONSIDERATIONS

We have identified several key technology matters that you should or may have considered already with regard to operating a retail apparel chain in Canada.

Accounting Software

In deciding on specific accounting software for your entity, management should decide if they would like to implement an off-the-shelf or customized package. We understand that there are a range of software companies such as Sage, ADP, Hyperion, SAP, and GEAC that can provide solutions for your retail accounting environment. Management should consider the functionality required from the software, the cost to implement the software and determine whether it can be integrated with other software used both locally and internationally.

We would be more than pleased to discuss options with you if necessary at your convenience.

POS System

A POS system will form an essential part of the technology infrastructure of your retail operation in Canada. Clearly, it is vital that the POS system be reliable, efficient, and secure in processing sales transactions. In addition to the sales function, the POS system should assist in managing inventory levels, lowering inventory costs, tracking sales by product line in order to forecast demand, support coupon redemption, gift certificates, prevent shrinkage and increase productivity at the sales level.

It is our understanding that there are currently two options for the underlying deployment platforms for POS peripherals: Java technology and OPOS. Furthermore, it is our understanding that a majority of our retail clients utilize Java technology given that it is designed to work with multiple operating systems and software, such as, but not limited to LINUX and Windows.

Some of the more popular POS developers that have been implemented by our clients and other retailers in Canada include but are not limited to: Volante, 360 Commerce, Retek Inc., Oracle, JDA Software Group Inc. Tomax Corporation, Wincor, Nixdorf and Sun Microsystems Inc.

We would be more than pleased to discuss this further with you and assist you in your selection of a POS system that suits your needs, if necessary.

General Computing Environment

The implementation of a strong general computing environment is key to the operation of a successful retailer. A strong general computing environment will ensure that your risks are mitigated with regards to business interruption, security breaches and loss of confidential information. A general computing environment includes many facets at both the store and corporate level that could be implemented by either a software development company such as ADP or a management consulting operation.

OTHER CONSIDERATIONS

Privacy Laws

As you may already know, Canada has strict laws with regards to the protection of personal information that is compiled by retailers in Canada. The introduction of the Personal Information Protection and Electronics Document in 2004 dictates how Canadian retailers may collect, use or disclose information that is obtained during normal course of operations.

Internal and External Fraud

We recognize that both internal and external fraud is a significant issue facing retailers. We have noted below several of the key fraud concerns, followed by a discussion that highlights some of the key preventative and detective measures that we consider important in minimizing these risks.

This list is not intended to cover all of the potential fraud concerns and solutions but hopes to address some of key fraud challenges facing entities operating in the retail sector, and provide certain measures to consider.

Common Types of Fraud

a) Employee Fraud

Preventing employee theft is a constant challenge for retailers. The industry knows that it must put systems in place to prevent or deter internal theft.

b) Payment Fraud

In recent years, payment fraud has been a hot topic with Canadian retailers. We understand that some of the more common types of payment fraud in the industry are stolen chequebooks, cheque guarantee cards, credit cards and debit cards, which are used to defraud retailers. The culprit may even have other stolen documents, belonging to the genuine cardholders, to support the use of the stolen card.

c) Credit Fraud

This type of fraud includes, but is not limited to retailers that provide credit to customers. The credit is often times approved, however in many cases the customers do not make payments or otherwise provide false addresses and banking information

d) Refund Fraud

In several cases, we noted that retailer's face a situation in which a customer may steal goods from a store and then return the stolen goods for a refund by use of a forged till receipt or by use of a proper receipt from previous transactions.

e) Currency and Gift Card Fraud

Due to the improvement in the technology for scanning for forged currency, the risk to the retailer of currency fraud has decreased. However, given the significant increase in gift card and certificate use by retailers, this area of fraud has increased significantly

Prevention and Detection

To be effective, loss prevention systems must be designed to reduce the opportunity, desire, and motivation for employee theft. Basic loss prevention steps involve strong procedures for hiring, training, and supervision of employees and managers. Procedures that are clearly defined, articulated, and fully implemented will reduce the opportunity, desire, and motivation for employees to steal.

We have noted that some retailers use a POS system, which, via the computer network, automatically obtain authorization for every plastic card transaction. This detects cards immediately after they have been stolen. Staff may also be trained to complete specific procedures to help reduce the fraud, such as watching the customer sign the card and then ensuring that the signatures match.

Practices such as imposing credit limits, and monitoring long over-due accounts can help reduce credit fraud.

Refund fraud is difficult to divert for a retailer that provides for a 'lenient' refund policy to its customers. However, in the case that a retailer chooses to continue with a lenient policy for returns, we recommend that the retailer follow some of the more 'common sense' recommendations such as taking name and address of person returning the product, offering credit notes instead of refunds, and insisting on the original packaging be returned with the goods.

A strong POS system will significantly reduce the risk of fraud for gift cards. The risk of fraud by way of gift certificates can be reduced by increasing staff awareness to this risk and by building in basic controls that will assist in reducing this risk.

In addition to implementing the above measures, it is imperative that every entity design and manage an effective entity-wide internal system of control with formal policies and procedures.

CONCLUDING REMARKS

We hope that the above discussion has provided you with an overview of the significant financial reporting, technology and other considerations that may impact your entity, should you decide to operate a retail business in Canada.

Cunningham LLP would be pleased to discuss further any of these considerations addressed in this letter, as well as any other concerns you may have at this time or in the future. We look forward to hearing from you.