ENVOY COMMUNICATIONS GROUP INC
Form 20-F/A
February 06, 2004

Table of Contents

As filed with the Securities and Exchange Commission on February 6, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F/A

[ ] Registration statement pursuant to Section 12(b) or 12(g) of the Securities Exchange Act of 1934

OR

[X] Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended September 30, 2002

OR

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from __ to __

Commission file number 0-30082

ENVOY COMMUNICATIONS GROUP INC.

(Exact name of Registrant as specified in its charter)

(Translation of Registrant s name into English)
Ontario, Canada

(Jurisdiction of incorporation or organization)

172 John Street, Toronto, Ontario, Canada M5T 1X5

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act: None

Securities registered or to be registered pursuant to Section 12(g) of the Act.

COMMON SHARES

(Title of Class)

The Nasdaq Small Cap Market

(Name of each exchange on which registered)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

NONE

(Title of Class)

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report: At September 30, 2002 there were 21,528,694 common shares outstanding.

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES [X] NO [ ]

Indicate by check mark which financial statement item the Registrant has elected to follow: Item 17 [ ] Item 18 [X]

Currency and Exchange Rates Information
All monetary amounts contained in this Form 20-F are, unless otherwise indicated, expressed in Canadian dollars. On February 17, 2003 the noon buying rate for Canadian Dollars as reported by the Federal Reserve Bank of New York was $1.00 U.S. to $**1.5209 Cdn**. (see Item 9 for further exchange rate information to U.S. currency.)

TABLE OF CONTENTS

PART III
Item 17. FINANCIAL STATEMENTS
Item 18. FINANCIAL STATEMENTS
Item 19. EXHIBITS
SIGNATURES
EX-12.1
EX-13.1

Table of Contents

EXPLANATORY NOTE

Shareholders equity and net loss for the year based on U.S. GAAP as at, and for the year ended September 30, 2002 differ from the amounts previously reported by the Company in its Annual Report on Form 20-F dated February 17, 2003, constituting its Annual Information Form. Previously, the Company expensed the beneficial conversion associated with its convertible debentures, and described in note 20(e), totalling $1,188,356, immediately. However, this amount should have been amortized over the two-year term of the debentures which would reduce the charge in 2002 to $168,541, resulting in a decrease to net loss for the year based on U.S. GAAP of $1,019,815. Accordingly, note 20 to the Company s consolidated financial statements included in this amended filing has been restated to correct for this matter. This amended filing should be read in conjunction with the Company s Annual Report on Form 20-F dated February 17, 2003.

PART III

Item 17. FINANCIAL STATEMENTS

Envoy has elected to provide financial statements pursuant to Item 18.

Item 18. FINANCIAL STATEMENTS

(a) Envoy Communications Group Inc.

(i)	Auditors Report on the financial statements for the year ended September 30, 2002 and 2001	F-1
	Comments by auditors for U.S. readers on Canada-U.S. reporting difference	
(ii)	Consolidated Balance Sheets as at September 30, 2002 and 2001	F-2
(iii)	Consolidated Statements of Operations for the years ended September 30, 2002, 2001 and 2000	F-3
(iv)	Consolidated Statements of Retained Earnings for the years ended September 30, 2002, 2001 and 2000	F-4
(v)	Consolidated Statements of Cash Flows for the years ended September 30, 2002, 2001 and 2000	F-5
(vi)	Notes to Consolidated Financial Statements	F-6

Item 19. EXHIBITS

(a) Exhibit 1 By-Law No. 1 of Envoy (as amended on May 2, 2000) & Articles of Incorporation. Incorporated by reference from the annual report, on form 20-F previously filed the Securities Exchange Commission on May 15, 2000.

Exhibit 12.1 Certifications required by Rule 13a-14(a)

Exhibit 13.1 Certifications required by Rule 13a-14(b)

Table of Contents

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F/A and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Envoy Communications Group Inc.

Date: February 6, 2004

/s/ Geoffrey B. Genovese

Name: Geoffrey B. Genovese
Title: Chairman, President and Chief Executive Officer

Table of Contents

Consolidated Financial Statements
(Expressed in Canadian dollars)

ENVOY COMMUNICATIONS GROUP INC.

Years ended September 30, 2002, 2001 and 2000

Table of Contents

KPMG LLP
Chartered Accountants
Yonge Corporate Centre
4100 Yonge Street Suite 200
Toronto ON M2P 2H3

Telephone (416) 228-7000
Telefax (416) 228-7123
www.kpmg.ca

AUDITORS REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Envoy Communications Group Inc. as at September 30, 2002 and 2001 and the consolidated statements of operations, retained earnings (deficit) and cash flows for each of the years in the three-year period ended September 30, 2002. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards and United States generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2002 and 2001 and the results of its operations and its cash flows for each of the years in the three-year period ended September 30, 2002 in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

Toronto, Canada

January 9, 2003, except
as to note 20(l) which is
as of February 2, 2004

Table of Contents

KPMG LLP
Chartered Accountants
Yonge Corporate Centre
4100 Yonge Street Suite 200
Toronto ON M2P 2H3

Telephone (416) 228-7000
Telefax (416) 228-7123
www.kpmg.ca

COMMENTS BY AUDITORS FOR U.S. READERS ON CANADA-U.S REPORTING DIFFERENCES

In the United States, reporting standards for auditors require the addition of an explanatory paragraph (following the opinion paragraph) when the financial statements are affected by conditions and events that cast substantial doubt on the Company s ability to continue as a going concern, such as those described in note 1 to the consolidated financial statements, and when there is a retroactive adjustment such as that described in note 20(l) to the consolidated financial statements. Our report to the shareholders dated January 9, 2003, except as to note 20(l) which is as of February 2, 2004, is expressed in accordance with Canadian reporting standards, which do not permit a reference to such events and conditions and which do not require a reference to such retroactive adjustment in the auditors report when such events and conditions and such adjustments are adequately disclosed in the financial statements.

Chartered Accountants

Toronto, Canada

January 9, 2003, except
as to note 20(l) which is
as of February 2, 2004

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Consolidated Balance Sheets
(Expressed in Canadian dollars)

September 30, 2002 and 2001

	2002	2001
Assets		
Current assets:		
Cash	$ 469,909	$ 21,781,809
Restricted cash (note 4)	1,831,085	158,500
Accounts receivable (note 5)	20,528,048	26,940,137
Income taxes recoverable	2,779,717	230,389
Future income taxes (note 13)	855,000	712,000
Prepaid expenses	983,068	1,315,009
	27,446,827	51,137,844
Capital assets (note 7)	7,836,728	11,533,736
Goodwill (note 8)	11,314,283	49,675,115
Other assets (note 9)	116,649	681,387
Future income taxes (note 13)	2,459,228	822,156
	$ 49,173,715	$ 113,850,238
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 21,019,267	$ 38,728,210
Deferred revenue	1,475,671	300,071
Amounts collected in excess of pass-through costs incurred	2,104,522	1,574,407
Bank credit facility and current portion of long-term debt (note 10)	10,589,114	10,965,089
	35,188,574	51,567,777
Long-term debt (note 10)	3,413,697	963,076
Long-term portion of restructuring costs (note 15)	792,275	
Shareholders equity:		
Share capital (note 12)	54,339,390	54,883,305
Convertible debentures (note 11)	1,720,859	
Retained earnings (deficit)	(47,629,529)	5,603,200
Cumulative translation adjustment	1,348,449	832,880
	9,779,169	61,319,385
Future operations (note 1)		
Commitments and contingencies (notes 3 and 16)		
Subsequent events (note 19)		
Reconciliation to United States generally accepted accounting principles (note 20)		
	$ 49,173,715	$ 113,850,238

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Director

Director

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Consolidated Statements of Operations
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

	2002	2001	2000
Net revenue	$ 59,121,090	$82,785,541	$60,790,280
Operating expenses:			
Salaries and benefits	45,096,981	53,653,694	35,132,814
General and administrative	11,669,901	17,373,429	12,953,898
Occupancy costs	4,728,817	4,754,875	2,552,854
	61,495,699	75,781,998	50,639,566
Earnings (loss) before depreciation, amortization of intangible asset, interest expense, unusual items, restructuring costs, income taxes, goodwill amortization and write-down	(2,374,609)	7,003,543	10,150,714
Depreciation	2,858,641	2,866,679	1,986,691
Amortization of intangible asset (note 9)	24,197		
Interest expense	1,245,126	743,600	407,473
Earnings (loss) before unusual items, restructuring costs, income taxes, goodwill amortization and write-down	(6,502,573)	3,393,264	7,756,550
Unusual items (note 14)	750,648	1,917,334	
Restructuring costs (note 15)	10,857,534		
Earnings (loss) before income taxes, goodwill amortization and write-down	(18,110,755)	1,475,930	7,756,550
Income taxes (recovery), excluding the undernoted	(4,853,540)	1,259,731	3,252,354
Impact of tax rate changes		100,000	
Earnings (loss) before goodwill amortization and write-down	(13,257,215)	116,199	4,504,196
Goodwill amortization, net of income tax recovery of $24,000 (2001 - $24,000; 2000 - $24,000)	2,187,509	3,011,571	1,593,769
Write-down of goodwill (note 8)	37,934,711		
Net earnings (loss)	$(53,379,435)	$ (2,895,372)	$ 2,910,427
Earnings (loss) per share (notes 2(i) and 12(e)):			
Basic	$ (2.54)	$ (0.14)	$ 0.15
Diluted	(2.54)	(0.14)	0.15
Earnings (loss) per share before goodwill amortization and write-down (notes 2(i) and 12(e)):			
Basic	(0.63)	0.01	0.24
Diluted	(0.63)	0.01	0.23

See accompanying notes to consolidated financial statements.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Consolidated Statements of Retained Earnings (Deficit)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

	2002	2001	2000
Retained earnings, beginning of year	$ 5,603,200	$ 8,403,367	$5,492,940
Gain on redemption of shares (note 12(c))	146,706	95,205	
Net earnings (loss)	(53,379,435)	(2,895,372)	2,910,427
Retained earnings (deficit), end of year	$(47,629,529)	$ 5,603,200	$8,403,367

See accompanying notes to consolidated financial statements.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Consolidated Statements of Cash Flows
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

	2002	2001	2000
Cash flows from operating activities:			
Net earnings (loss)	$(53,379,435)	$ (2,895,372)	$ 2,910,427
Items not involving cash:			
Future income taxes	(1,780,072)	(567,441)	(285,344)
Depreciation	2,858,641	2,866,679	1,986,691
Amortization of intangible asset	24,197		
Goodwill amortization	2,211,509	3,035,571	1,617,769
Write-down of goodwill	37,934,711		
Amortization of deferred financing charges	96,263	65,936	9,990
Write-down of deferred financing charges	750,648		
Convertible debentures accretion	133,870		
Restructuring costs:			
Write-down of capital assets	3,481,105		
Other	52,500		
Net change in non-cash working capital balances:			
Restricted cash	(1,672,585)	297,962	
Accounts receivable	6,757,260	7,389,275	1,823,856
Prepaid expenses	353,652	(174,654)	124,424
Accounts payable and accrued liabilities	(16,905,696)	12,440,922	(10,519,909)
Income taxes payable/recoverable	(2,606,457)	(1,145,133)	(787,622)
Deferred revenue	1,175,600	(758,380)	1,044,873
Amounts collected in excess of pass-through costs incurred	(175,514)	(777,930)	518,410
Other	(209,582)	159,003	(126,812)
Net cash provided by (used in) operating activities	(20,899,385)	19,936,438	(1,683,247)
Cash flows from financing activities:			
Long-term debt borrowings	1,580,459	8,137,183	5,198,442
Long-term debt repayments	(2,539,248)	(8,097,536)	(5,497,140)
Issuance of common shares		383,670	10,939,807
Issuance of convertible debentures	3,800,000		
Redemption of common shares	(628,083)	(1,295,475)	
Reduction (increase) in restricted cash		394,625	(277,330)
Long-term portion of restructuring costs	792,275		
Other		190,143	
Net cash provided by (used in) financing activities	3,005,403	(287,390)	10,363,779

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Consolidated Statements of Cash Flows (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

	2002	2001	2000
Cash flows from investing activities:			
Acquisition of subsidiaries, net of cash acquired (bank indebtedness assumed) of $919,201 (2001 - $214,179; 2000 - ($941,385))	(1,904,742)	(1,669,168)	(14,640,994)
Purchase of capital assets	(1,811,154)	(3,756,134)	(2,428,228)
Increase in other assets			(67,356)
Net cash used in investing activities	(3,715,896)	(5,425,302)	(17,136,578)
Change in cash balance due to foreign exchange	297,978	452,645	261,010
Increase (decrease) in cash	(21,311,900)	14,676,391	(8,195,036)
Cash, beginning of year	21,781,809	7,105,418	15,300,454
Cash, end of year	$ 469,909	$21,781,809	$ 7,105,418
Cash flows from operations per share (note 12(e)):			
Basic	$ (0.36)	$ 0.12	$ 0.33
Diluted	(0.36)	0.12	0.33
Supplemental cash flow information:			
Interest paid	$ 643,926	$ 704,604	$ 407,474
Income taxes paid	581,077	3,407,801	3,489,185
Supplemental disclosure of non-cash transactions:			
Shares issued for non-cash consideration	265,500	3,908,156	6,850,311
Capital assets acquired under capital leases	820,424		

See accompanying notes to consolidated financial statements.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

The Company, continued under the Business Corporations Act (Ontario), has operations in the United States, the United Kingdom and Canada and provides integrated marketing and communication services. The core disciplines are: advertising, branding and digital professional services, which include strategy, creative design and technology infrastructure services necessary to build and maintain successful e-businesses.

1. Basis of presentation:

(a) These consolidated financial statements have been prepared on the going concern basis, which assumes the Company will continue its operations in the foreseeable future and will be able to realize its assets and satisfy its liabilities in the normal course of business. Certain conditions exist and events have occurred, as further described below that provide uncertainty regarding the Company s ability to continue as a going concern, with its existing operations.

During the year, the Company entered into a Forebearance Agreement with the lenders, which requires the Company to make monthly principal payments from December 31, 2002 through to March 31, 2003 and repay the balance of the loan by April 30, 2003. Consequently, the loan is classified as a current liability and the working capital shortfall is approximately $7.7 million as at September 30, 2002.

The Company s ability to repay its bank borrowings is dependent upon its ability to generate positive cash flow from operations, secure additional debt or equity financing under private placements, refinance or renegotiate its debt facility and/or sell all of, or a part of, its operating businesses. There can be no assurances that the Company will be successful in doing so. In the event the Company is unable to repay or refinance the bank loans from the above sources, then the application of the going concern principle for financial statement reporting purposes may no longer be appropriate. These consolidated financial statements do not include any adjustments related to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that may be necessary.

(b) The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada, which vary in certain significant respects from generally accepted accounting principles in the United States. A description of the significant differences, as applicable to the Company, is included in note 20.

(c) Certain 2001 comparative figures have been reclassified to conform to the financial statement presentation adopted for 2002.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

2. Significant accounting policies:

(a) Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries, collectively known as Envoy Communications Group Inc. Intercompany balances and transactions are eliminated on consolidation.

Significant subsidiaries as at September 30, 2002 are as follows:

Company	% of ownership	Jurisdiction of incorporation
Communique Incentives Inc.	100	Ontario
Hampel Stefanides, Inc.	100	Delaware
Devlin Multimedia Inc.	100	Ontario
Watt International Inc.	100	Ontario
Sage Information Consultants Inc.	100	Ontario
Gilchrist Brothers Limited	100	United Kingdom
International Design Group	100	Ontario
John Street Inc.	70	Ontario

(b) Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

2. Significant accounting policies (continued):

(c) Capital assets:

Capital assets are recorded at cost and are depreciated over their estimated useful lives as follows:

Asset	Basis	Rate
Audiovisual equipment	Straight line	2 - 5 years
Computer equipment and software	Declining balance	30% - 50%
Furniture and equipment	Declining balance	20%
Leasehold improvements	Straight line	Over term of leases
Equipment under capital leases	Straight line	3 - 5 years

(d) Revenue recognition:

The Company presents as net revenue its net commission and fee income earned as compensation for its services. Further, the balance sheet reflects the following:

(i) deferred revenue representing only fees billed and collected in advance of such fees being earned; and

(ii) the reimbursable pass-through costs which are included in unbilled accounts receivable.

Net revenue represents the Company s compensation for its agency and non-agency services and is recognized only when collection of such net revenue is probable. Agency services are those that require the Company to incur external media and production costs on behalf of its clients and for which it is entitled to pass through the costs for reimbursement from its clients. The reimbursement of pass-through costs are not included in net revenue. The Company s agency and non-agency projects are short-term in nature.

Fees earned for non-agency services are recognized either upon the performance of the Company s services when the Company earns a per-diem fee, or in the case of a fixed fee, when the Company s services are substantially complete and accepted by the client. Fees earned but not yet billed are included in accounts receivable. Fees billed to clients in excess of fees recognized as net revenue are classified as deferred revenue.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

2. Significant accounting policies (continued):

When the Company s compensation for its agency services is based on commissions, net revenue is comprised of: (i) commissions earned from media expenditures, which are recognized at the time the advertising appears or is broadcast, or in respect of on-line advertising, either ratably over the period of time the advertising appears or based on the actual impressions delivered at the contractual rate per impression, depending upon the terms of the arrangement; and (ii) commissions earned on expenditures for the production of advertisements, which are recognized upon the completion of the Company s services and acceptance by the client, being the time at which the Company has no further substantial obligations with respect thereto.

When the Company s compensation for its agency services is fee-based, net revenue is comprised of non-refundable monthly agency fees, which are recognized in the month earned.

Pass-through costs related to production are accrued and recorded in accounts receivable, as unbilled reimbursable costs, at the time the third party suppliers render their services. Pass-through costs related to media are accrued at the time the advertisement appears or is broadcast.

(e) Goodwill:

Goodwill acquired prior to July 1, 2001 is initially stated at cost with amortization being provided on a straight-line basis over periods ranging from 7 to 25 years.

As further described in notes 2(i)(ii) and 20(k)(ii)), in accordance with new accounting standards, goodwill acquired after July 1, 2001 is not amortized but is tested at least annually for impairment.

Annually, the Company assesses the recoverability of the carrying value of its goodwill and the related amortization period. As part of the evaluation, the Company considers several factors, including the operating results and trends, movement in major clients and key client service personnel, changes in client relationships and general economic conditions. Significant changes in these factors could result in a permanent impairment of goodwill.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

2. Significant accounting policies (continued):

Goodwill is considered to be impaired if the future anticipated undiscounted operating cash flows from the acquired businesses are less than the carrying value of the goodwill. These cash flow projections require management to make certain assumptions regarding future revenue and expenses. When impairment is determined, the related loss is charged to earnings and is measured by the excess of the carrying value of the goodwill over its fair value based on estimated discounted future operating cash flows. The impact of such write-downs on the amortization period is simultaneously assessed.

(f) Foreign currency translation:

The financial statements of the Company s foreign subsidiaries, all of which are self-sustaining operations, are translated using the current rate method, whereby the assets and liabilities of such foreign operations are translated at the exchange rate in effect at the balance sheet date. Revenue and expenses are translated at the average exchange rate for the year. Translation gains or losses are deferred and included as a separate component of shareholders equity.

In respect of the Company s and its subsidiaries foreign currency transactions, at the transaction date, each asset, liability, revenue and expense is translated into Canadian dollars by the use of the exchange rate in effect at that date. At the year-end date, monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at that date. The resulting foreign exchange gains and losses are included in earnings in the current year. However, unrealized gains or losses on long-term debt that is designated as a hedge of investments in foreign subsidiaries are deferred and recorded as a separate component of shareholders equity.

(g) Income taxes:

The Company accounts for income taxes using the asset and liability method. Under this method, future income taxes are recognized at the enacted or substantially enacted tax rate expected to be applicable at the date of reversal for all significant temporary differences between the tax and accounting bases of assets and liabilities and for certain tax carryforward items. Future income tax assets are recognized only to the extent that, in the opinion of management, it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of the substantive enactment of the change.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

2. Significant accounting policies (continued):

(h) Stock-based compensation:

The Company has a stock option plan for key employees and officers. All stock options issued under this plan have an exercise price equal to or greater than the fair market value of the underlying common shares on the date of the grant. The Company does not record compensation expense on the grant or modification of options under the Plan. Consideration paid by employees on the exercise of stock options is recorded as share capital. The stock option plan is described in note 12(d).

(i) Changes in accounting policies:

(i) The Company adopted the new provisions of The Canadian Institute of Chartered Accountants (CICA) Handbook Section 3500, Earnings per Share. Basic earnings per share is computed using the weighted average number of common shares that are outstanding during the year. Diluted earnings per share is computed using the weighted average number of common and potential common shares outstanding during the year. Potential common shares consist of the incremental common shares issuable upon the exercise of stock options using the treasury stock method.

Previously, the Company calculated fully diluted earnings per share using the imputed earnings method. The change in accounting policy has been applied retroactively and the diluted earnings per share figures presented for the comparative periods have been restated.

(ii) The Company adopted the new provisions of the CICA Handbook Section 1581, Business Combinations . All business combinations are accounted for using the purchase method of accounting. The value of shares issued in a business combination are measured using the average share price for a reasonable period before and after the date the terms of the acquisition are agreed to and announced. Effective July 1, 2001, goodwill acquired in business combinations completed after June 30, 2001 was not amortized and is subject to impairment testing. Intangible assets that meet specific criteria are recognized and reported apart from goodwill.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

3. Acquisition of subsidiaries:

(a) Effective October 1, 2001, the Company acquired 100% of the outstanding shares of Commodore Conference Planners Inc. (Commodore), a conference and event marketing company. Under the terms of the acquisition, the initial purchase price consisted of $611,113 in cash consideration excluding acquisition costs. Of this cash consideration, $50,000 is included in accounts payable at September 30, 2002 and will be paid upon the receipt of income taxes recoverable as provided in the purchase agreement. Additional consideration, to a maximum of $475,000 cash, may be paid over a two-year period if certain performance milestones are achieved for the 12-month periods ending September 30, 2002 and 2003. For the twelve months ended September 30, 2002, an earn-out payment of $193,000 is owing and is included in accounts payable. As additional milestones are met, the amounts will be accounted for as additional goodwill.

The acquisition of Commodore has been accounted for using the purchase method of accounting. The fair value of the net assets acquired at October 1, 2001 and consideration accounted for to date was as follows:

Capital assets	$ 11,160
Non-compete agreement	72,590
Non-cash working capital	(517,544)
Net liabilities	(433,794)
Consideration, less cash acquired of $919,200, October 1, 2001	(171,187)
Additional cash consideration included in accounts payable, earn-out for 2002	193,000
Excess of purchase price over fair value of net assets acquired allocated to goodwill	$ 455,607

The amount assigned to the non-compete agreement is amortized over the term of the agreement. As a result of the adoption of new accounting standards for business combinations, the goodwill arising in connection with this acquisition is not amortized (note 2(i)(ii)).

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

3. Acquisition of subsidiaries (continued):

(b) Effective January 1, 2001, the Company acquired 100% of the outstanding shares of International Design Group, a Toronto-based international retail planning and design firm. Under the terms of the acquisition, the initial purchase price, which consisted of $1,090,000 in cash consideration and 61,728 common shares of the Company with a fair value of $284,332, was paid upon closing. Additional consideration may be paid over a three-year period if certain performance milestones are achieved for the 12-month periods ending December 31. The earn-out amounts earned will be satisfied by a maximum of $2,000,000 in cash and a maximum of 154,321 common shares of the Company. No amounts were owing by the Company in 2002 under the earn-out agreements. The acquisition has been accounted for using the purchase method of accounting.

The fair value of the net assets acquired was $1,198,684, excluding cash acquired of $214,179. The net assets acquired consisted of working capital and capital assets. The resulting excess purchase price over the fair value of the net assets acquired of $336,382 was allocated to goodwill and is being amortized over 25 years.

(c) Effective July 1, 2000, the Company acquired 100% of the outstanding shares of Gilchrist Brothers Limited (Gilchrist), a United Kingdom-based digital imaging and design firm, in exchange for cash consideration of $3,235,798 (£1,460,000) and a $5,325,215 (£2,402,750) non-interest bearing promissory note, repayable in semi-annual instalments over the next two years to June 30, 2002. The present value of the promissory note of $5,067,763 (£2,261,486), together with the initial cash consideration, represent the total purchase price. At September 30, 2002, $295,615 (£118,749) (2001 - $2,689,781 (£1,156,200) is included in long-term debt (note 10). The acquisition has been accounted for using the purchase method of accounting and the resulting goodwill is being amortized over 20 years.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

3. Acquisition of subsidiaries (continued):

The fair value of the net assets acquired at July 1, 2000 and consideration accounted for to date was as follows:

Non-cash working capital	$ 1,046,094
Capital assets	2,001,319
Long-term debt	(2,165,325)
Net assets	882,088
Total consideration, including bank indebtedness assumed	8,593,970
Excess of purchase price over fair value of net assets acquired allocated to goodwill	$ 7,711,882

(d) Effective June 1, 2000, the Company, acquired 100% of the outstanding shares of Sage Information Consultants Inc. (Sage), a digital professional service firm operating in the United States and Canada, in exchange for cash consideration of $6,750,000 and the issuance of 503,145 common shares of the Company with a fair value of $4,000,000.

In June 2001, the Company determined that additional consideration was payable based on Sage s operating results for the 12 months ended May 31, 2001 and agreed to amend the terms of the purchase agreement with respect to the payment of the earn-out for this period. Under the amended terms, the Company agreed to pay $1,392,154 in cash consideration, rather than the issuance of cash and shares under the original terms. The excess of the cash consideration payable over the fair value of the cash and shares otherwise issuable amounted to $362,485 and is required to be expensed under generally accepted accounting principles. As a result, only $1,029,669 of the amount payable has been recorded as additional goodwill.

In March 2002, a settlement of the Company s obligations under the earn-out agreements was reached and a final payment of $225,000 in cash and 150,000 common shares with a value of $213,000 was made by the Company.

The acquisition has been accounted for using the purchase method of accounting and the resulting goodwill is being amortized over 10 years.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

3. Acquisition of subsidiaries (continued):

The fair value of the net assets acquired at June 1, 2000 and consideration accounted for to date was as follows:

Non-cash working capital	$ 104,663
Capital assets	141,578
Future income taxes	53,000
Net assets	299,241
Total consideration, including bank indebtedness assumed, June 1, 2000	12,270,724
Additional cash consideration in 2001	1,029,669
Settlement of final purchase price in 2002:	
Cash payment	225,000
Common shares issued	213,000
Total consideration, including bank indebtedness assumed, September 30, 2002	13,738,393
Excess of purchase price over fair value of net assets acquired allocated to goodwill	$13,439,152

(e) Effective October 1, 1998, the Company acquired 100% of the outstanding shares of Hampel Stefanides, Inc. (Hampel Stefanides), a full-service advertising and commercial design agency operating in the United States, in exchange for initial cash consideration of $5,587,349 (U.S. $3,649,000) and the issuance of 581,395 common shares with a fair value of $2,296,800 (U.S. $1,500,000). In September 1999, the Company recorded additional consideration of $4,134,002. The consideration was paid on November 4, 1999 by way of a cash payment of $1,703,802 and the issuance of 450,040 common shares of the Company with a fair value of $2,430,200. During fiscal 2000, additional cash consideration of $554,788 (U.S. $375,000) was paid. Additional cash consideration of $375,875 (U.S. $250,000) is included in accounts payable and accrued liabilities as at September 30, 2001 and has been included as part of total consideration.

In September 2000, the Company determined that additional consideration was owing, in the form of cash and shares of the Company, based on Hampel Stefanides operating results for the year ended September 30, 2000 and such amount has been recorded as at September 30, 2000. The aggregate consideration of $5,348,600 was paid on November 1, 2000 by way of a cash payment of $1,724,776, which is included in accounts payable and accrued liabilities, and the issuance of 444,641 common shares of the Company with a fair value of $3,623,824, which were included in share capital as at September 30, 2000.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

3. Acquisition of subsidiaries (continued):

In December 2001, the Company determined that additional consideration was owing in the form of cash and shares, based on Hampel Stefanides operating results for the year ended September 30, 2001 and such amount has been recorded as at September 30, 2001. The aggregate consideration of $2,909,150 consists of cash consideration of $1,900,929, which is included in accounts payable and accrued liabilities, and the issuance of 466,769 common shares of the Company with a fair value of $1,008,221, which were included in share capital as at September 30, 2001 as shares to be issued (note 12(a)). Subsequent to September 30, 2001, 34,626 common shares related to the 2001 earn-out were not issued. Correspondingly, the share capital of the Company has been reduced by $34,626.

The Company has no remaining obligations under the earn-out agreement in connection with Hampel Stefanides.

The acquisition has been accounted for using the purchase method of accounting and the resulting goodwill is being amortized over 25 years. The fair value of the net liabilities acquired on October 1, 1998 and consideration accounted for to date was as follows:

Non-cash working capital deficiency	$ (6,171,687)
Capital assets	1,676,664
Restricted cash	765,600
Net liabilities	(3,729,423)
Consideration, less cash acquired, September 30, 1999	7,475,961
Additional consideration, September 30, 2000:	
Cash	1,724,776
Issuance of 444,641 common shares	3,623,824
Additional consideration, September 30, 2001 :	
Cash	1,900,929
Issuance of 466,769 common shares	1,008,221
Additional consideration, September 30, 2002:	
Shares not issued relating to 2001 earn-out	(34,626)
Total consideration, less cash acquired, September 30, 2002	15,699,085
Purchase price and fair value of net liabilities acquired allocated to goodwill	$ 19,428,508

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

4. Restricted cash:

Restricted cash includes a trust account established for Communique Incentives Inc. for customer deposits of $1,831,085 (2001 $158,500).

5. Accounts receivable:

	2002	2001
Trade receivables	$12,433,301	$20,501,517
Accrued revenue	6,719,441	4,100,289
Unbilled pass-through costs	1,375,306	2,338,331
	$20,528,048	$26,940,137

6. Related party transactions:

Subsequent to September 30, 2002 (note 19(a)), the Company sold the operations of Devlin Multimedia Inc. (Devlin) and Sage to certain executives of the respective subsidiaries.

Included in accounts receivable as at September 30, 2001 is a net balance of $321,893 owing from the former owner of Sage in respect of indemnified receivables, net of the earn-out payment owing by the Company (note 3(d)).

Related party transactions are recorded at the exchange amount, being the amount agreed to by the related parties.

7. Capital assets:

2002	Cost	Accumulated depreciation	Net book value
Audiovisual equipment	$ 780,918	$ 762,386	$ 18,532
Computer equipment and software	13,115,157	8,665,300	4,449,857
Furniture and equipment	1,427,777	1,151,402	276,375
Leasehold improvements	8,233,909	6,316,255	1,917,654
Equipment under capital leases	1,940,971	766,661	1,174,310
	$25,498,732	$17,662,004	$7,836,728

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

7. Capital assets (continued):

2001	Cost	Accumulated depreciation	Net book value
Audiovisual equipment	$ 780,919	$ 750,126	$ 30,793
Computer equipment and software	10,704,399	7,575,183	3,129,216
Furniture and equipment	3,967,088	2,714,054	1,253,034
Leasehold improvements	9,700,446	3,209,833	6,490,613
Equipment under capital leases	1,393,849	763,769	630,080
	$26,546,701	$15,012,965	$11,533,736

8. Goodwill:

2002	Cost	Accumulated amortization	Net book value
Goodwill	$57,417,846	$46,103,563	$11,314,283

2001	Cost	Accumulated amortization	Net book value
Goodwill	$55,644,858	$5,969,743	$49,675,115

The Company performed an assessment of the carrying values of goodwill recorded in connection with its various businesses. The assessment was performed because a number of factors indicated that an impairment had arisen commencing in the period ending March 31, 2002. The main indicators of impairment were significant negative industry and economic trends impacting both current operating results and expected future growth rates and loss of significant clients. Based on these factors, the Company concluded that significant permanent impairment existed with respect to the Company s goodwill and other assets, which primarily related to the goodwill associated with the businesses of Sage, Promanad and Hampel Stefanides.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

8. Goodwill (continued):

In quantifying the impairment charge, the Company compared the expected future cash flows of each acquisition, to the respective carrying value of the assets of the business, including assigned goodwill. The cash flow periods used ranged between 5 and 25 years, consistent with the remaining goodwill amortization period.

As a result of the review, the Company determined that the carrying values of certain acquired businesses were not fully recoverable. Accordingly, the Company recorded two write-downs: $28,426,266 in the second quarter of 2002 and $9,508,445 in the fourth quarter of 2002 based on the amount by which the goodwill exceeded the expected future cash flows of the respective operation.

9. Other assets:

	2002	2001
Deferred financing charges	$	$634,936
Non-compete agreement, net of accumulated amortization of $24,197 (note 3(a))	48,394	
Other	68,255	46,451
	$116,649	$681,387

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

10. Bank credit facility and other debt:

	2002	2001
Bank credit facility (a)	$ 9,838,192	$ 7,841,329
Promissory note, 8% per annum, repayable in five monthly instalments commencing June 30, 2002 (b)	295,615	2,689,781
Loan payable to landlord, 3.5% per annum, due July 1, 2009, repayable in monthly instalments of $7,665 principal and interest	553,992	625,382
Loan payable to landlord, 0.925% per annum, due December 1, 2002, repayable in monthly instalments of $6,728 principal and interest	20,185	100,925
Loan payable to landlord, 10.0% per annum, due March 1, 2010, repayable in monthly instalments of $3,956 principal and interest	251,444	357,016
Loan payable to landlord, 10.0% per annum, due April 1, 2005, repayable in monthly instalments of $742 principal and interest	37,001	
Loan payable to landlord, 8.0% per annum, due April 1, 2010, repayable in monthly instalments of $561 principal and interest	38,337	
Capital lease, 12.3% over the lease period, repayable in quarterly instalments of $63,056 (£25,330) (2001 - $60,129 (£25,330)) principal and interest, due January 2003	64,123	284,507
Capital leases, 10.3% to 13. 9% over the lease period, repayable in quarterly instalments of $15,997 (£6,426) (2001 - $14,950 (£19,750)) principal and interest, due between March 2002 and April 2002		29,225
Capital leases, 10.2% to 14% over the lease period, repayable in monthly instalments of $33,136 principal and interest, due between January 2005 and February 2005	820,424	
Convertible debentures (note 11)	2,083,498	
	14,002,811	11,928,165
Less current portion	10,589,114	10,965,089
	$ 3,413,697	$ 963,076

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

10. Bank credit facility and other debt (continued):

(a) During the year, the Company was in violation of certain provisions under its bank credit facility. As at September 30, 2002, the Company has entered into a Forebearance Agreement with the lenders under its bank credit facility, under which the Company is required to maintain certain financial tests. Under the Forebearance Agreement, unless there are further violations or defaults by the Company, the lenders have agreed not to enforce their rights or remedies under security agreements. The lenders still have the right to demand repayment of the borrowings at any time. The terms of the Forebearance Agreement require the Company to make a principal repayment of $2,000,000 in December 2002 and $1,000,000 in each of January, February and March 2003, with the balance due on April 30, 2003.

As permitted under the Forebearance Agreement, and subsequent amendments, the Company has letters of credit available to be issued in the amount of £250,000 and U.S. $500,000. The letters of credit expire on April 30, 2003.

Interest rates on the facility are variable based on certain leverage ratios and, at September 30, 2002, the effective interest rate was 8.50% (2001 4.25%). The facility is secured by a general security agreement guarantee against the Company and all of its subsidiaries.

Of the outstanding borrowings, $3,178,691 (U.S. $2,002,704) is denominated in U.S. dollars.

(b) During the third quarter, the Company negotiated new repayment terms for a promissory note originally due on June 30, 2002 in respect of the Gilchrist acquisition (note 3(c)) (the Gilchrist note). Under the revised terms, the Gilchrist note is to be repaid in five monthly instalments commencing July 1, 2002 with interest on the principal balance charged at 8% per annum.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

10. Bank credit facility and other debt (continued):

Principal repayments on long-term debt, excluding convertible debentures (note 11), are as follows:

2003	$10,589,114
2004	478,660
2005	265,071
2006	118,900
2007	189,599
Thereafter	277,969
	$11,919,313

11. Convertible debentures:

On April 29, 2002, the Company issued $1,800,000 in 10% convertible debentures which mature on April 29, 2007. The debentures are convertible until the maturity date into 2,500,000 units of the Company at a conversion price of $0.72 per unit. Each unit consists of one common share in the capital of the Company and one purchase warrant of the Company. Each purchase warrant entitles the holder to purchase one common share (2.5 million common shares in aggregate) within the earlier of (a) 12 months of the date of conversion of the debenture, and (b) the maturity date at a price of $0.90 per common share. Holders also have the right to require the Company to purchase all or a portion of their debentures on or after April 29, 2004 at the issue price plus accrued and unpaid interest. In addition, upon a change in control occurring on or before April 29, 2004, the Company will be required to offer to purchase the debentures at a purchase price equal to 101% of the issue price plus accrued and unpaid interest to the repurchase date. The debentures are secured by a charge over the Company s assets and undertakings, which charge will be subject only to security interests in favour of the Company s bankers, equipment leases and non-consensual liens. The net proceeds from the sale of the debentures were used for general corporate purposes.

The debentures are bifurcated into a debt component, representing a yield to maturity of 25.4% per annum over the five-year life, and an equity component with proceeds allocated as $1,017,770 to long-term debt and $782,230 to shareholders equity. That portion of offering expenses related to the debt component, being $60,587 has been recorded as deferred financing fees which are classified in prepaid expenses, and the remaining $46,565 applied to reduce the equity component.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

11. Convertible debentures (continued):

The principal amount of the debentures will increase as interest is compounded using an effective interest rate method over two years, being the earliest date at which they are redeemable at the option of the holder.

On September 12, 2002, the Company issued $2,000,000 in 10% convertible debentures which mature on September 12, 2007. The debentures are convertible until the maturity date into 5,882,353 units of the Company at a conversion price of $0.34 per unit. Each unit consists of one common share in the capital of the Company and one purchase warrant of the Company. Each purchase warrant entitles the holder to purchase one common share (5.9 million common shares in aggregate) within the earlier of (a) twelve months of the date of conversion of the debenture, and (b) the maturity date at a price of $0.34 per common share. Holders also have the right to require the Company to purchase all or a portion of their debentures on or after September 12, 2004 at the issue price plus accrued and unpaid interest. In addition, upon a change in control occurring on or before September 12, 2004, the Company will be required to offer to purchase the debentures at a purchase price equal to 101% of the issue price plus accrued and unpaid interest to the repurchase date. The debentures are secured by a charge over the Company s assets and undertakings, which charge will be subject only to security interests in favour of the Company s bankers, equipment leases and non-consensual liens. The net proceeds from the sale of the debentures were used for general corporate purposes.

The debentures are bifurcated into a debt component, representing a yield to maturity of 31.5% per annum over the five-year life, and an equity component with proceeds allocated as $931,858 to long-term debt and $1,068,142 to shareholders equity. That portion of the offering expenses related to the debt component, being $72,365, has been recorded as deferred financing fees which are classified in prepaid expenses, and the remaining $82,948 applied to reduce the equity component.

The principal amount of the debentures will increase as interest is compounded using an effective interest rate method over two years, being the earliest date at which they are redeemable at the option of the holder.

As at September 30, 2002, the aggregate debt component carrying values of all of the Company s convertible debentures is $2,083,498. Principal repayments, based on scheduled maturity dates, is $3,800,000 in 2007. However, this date may be accelerated to 2004, at the option of the holders of the debentures.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

12. Share capital:

(a) Authorized:

50,000,000 common shares without par value
(2001 - 50,000,000; 2000 - 50,000,000)

Issued:

	2002		2001		2000	
	Number of shares	Amount	Number of shares	Amount	Number of shares	Amount
Balance, beginning of year	21,192,719	$54,883,305	21,098,222	$54,597,762	18,349,005	$35,613,907
Common shares issued for cash pursuant to:						
Public offering					1,533,571	10,128,823
Stock options exercised			101,000	383,670	214,000	811,100
Acquisitions (note 3)	150,000	213,000	61,728	284,332	557,005	4,420,108
Repurchase of shares pursuant to share issuer bid	(299,400)	(774,789)	(535,000)	(1,390,680)		
Shares issued to settle liability with landlord (note 15)	250,000	52,500				
	21,293,319	54,374,016	20,725,950	53,875,084	20,653,581	50,973,938
Shares to be issued in respect of contingent consideration (note 3(e))	(34,626)	(34,626)	466,769	1,008,221	444,641	3,623,824
Balance, end of year	21,258,693	$54,339,390	21,192,719	$54,883,305	21,098,222	$54,597,762

(b) Public offering:

On June 5, 2000, the Company issued 1,533,571 common shares through a public share offering for gross proceeds of $7.00 per share and aggregate proceeds of $10,734,997. Net proceeds recorded as share capital were $10,128,823 after deducting issue costs of $1,195,965 and recording the related tax recovery of $589,791.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

12. Share capital (continued):

(c) Repurchase of shares:

During 2002, pursuant to a normal course issuer bid, the Company repurchased and cancelled 299,400 common shares at an average price of $2.10 per common share for total cash consideration of $628,083. As a result of these purchases, $146,706 was recorded in retained earnings as a gain on redemption.

During 2001, pursuant to a normal course issuer bid, the Company repurchased and cancelled 535,000 common shares at an average price of $2.42 per common share for total consideration of $1,295,475. As a result of these repurchases, $95,205 was recorded as a gain on redemption of shares in retained earnings. Under the terms of the normal course issuer bid, the Company may repurchase and cancel up to 10% of the public float to July 26, 2002.

(d) Stock option plan:

The Company has reserved 4,000,000 common shares under its stock option plan. Under the plan, the options are exercisable for one common share and the exercise price of the option must equal the market price of the underlying share at the grant date. Options granted after November 1997 have vesting periods ranging from date of grant and up to five years. Options granted prior to November 1997 vested upon grant. Once vested, options are exercisable at any time until expiry. Expiry dates range between 2002 and 2007.

In 2002, the Company obtained approval to re-price options. All employees, excluding insiders and U.S. employees, were given the opportunity to cancel their existing stock options with an exercise price greater than $6 per share and replace them with new stock options. Options were cancelled on January 31, 2002 and new options to acquire 50% of the number of options cancelled were granted on August 2, 2002 at an exercise price of $3.05.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

12. Share capital (continued):

Details of the options are as follows:

	Number of options	Weighted average exercise price per share
Options outstanding, September 30, 1999	2,076,500	$ 4.30
Options granted	774,000	7.43
Options exercised	(214,000)	3.79
Options cancelled	(296,000)	4.72
Options outstanding, September 30, 2000	2,340,500	5.33
Options granted	780,000	5.30
Options exercised	(101,000)	3.80
Options cancelled	(340,000)	5.87
Options outstanding, September 30, 2001	2,679,500	5.31
Options granted	1,719,000	1.15
Options cancelled	(1,199,500)	5.37
Options outstanding, September 30, 2002	3,199,000	3.06
Options exercisable, September 30, 2002	2,322,084	$ 3.35
Options exercisable, September 30, 2001	1,491,510	$ 5.07

The range of exercise prices for options outstanding and options exercisable at September 30, 2002 are as follows:

	Options outstanding			Options exercisable	
Range of exercise price	Number	Weighted average exercise price	Weighted average contractual life	Number	Weighted average exercise price
$0.61 - $3.05	1,799,000	$ 1.32	4.47 years	1,055,000	$ 1.03
$3.62 - $4.70	755,000	3.96	0.90 years	668,750	3.95
$6.20 - $8.15	645,000	6.84	0.32 years	598,334	6.78

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

12. Share capital (continued):

(e) Earnings (loss) and cash flows from operations per share:

The following table sets forth the computation of basic and diluted earnings (loss) per share:

	2002	2001	2000
Numerator:			
Net earnings (loss)	$(53,379,435)	$ (2,895,372)	$ 2,910,427
Denominator:			
Denominator for basic net earnings (loss) per share -weighted average shares outstanding	20,998,397	21,160,616	19,156,626
Effect of dilutive potential common shares:			
Shares issuable pursuant to warrants			75
Shares issuable under stock options			516,263
Denominator for diluted net earnings (loss) per share	20,998,397	21,160,616	19,672,964

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

12. Share capital (continued):

As the Company experienced a loss for the years ended September 30, 2002 and 2001, all potential common shares outstanding from dilutive securities are considered anti-dilutive and are excluded from the calculation of loss per share. Details of potential dilutive securities are as follows:

	2002	2001	2000
Effect of dilutive potential common shares:			
Shares issuable pursuant to warrants	7,882,353		75
Shares issuable under stock options	3,199,000	2,679,500	2,340,500
Shares to be issued in respect of contingent consideration		1,772,241	2,172,246
Shares issuable upon conversion of convertible debentures	8,382,353		

Basic and diluted cash flows from operations per share have been calculated using the cash flows from operating activities, excluding net changes in non-cash working capital balances.

13. Income taxes:

Income tax expense (recovery) for the years ended September 30, 2002, 2001 and 2000 consists of:

	2002	2001	2000
Current	$(3,073,468)	$1,927,172	$3,537,698
Future	(1,780,072)	(567,441)	(285,344)
	$(4,853,540)	$1,359,731	$3,252,354

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

13. Income taxes (continued):

The income tax expense (recovery) attributable to income (loss) from continuing operations differs from the amounts computed by applying the Canadian statutory rates of 39.5% (2001 - 42.5%; 2000 - 44.1%) pretax income (loss) as a result of the following.

	2002		2001		2000	
Income tax expense (recovery) at statutory rates	$(7,153,748)	(39.5)%	$ 627,270	42.5%	$3,420,638	44.1%
Increase (decrease) in income taxes resulting from:						
Adjustment to future tax assets for substantively enacted changes in tax laws and rates	654,691	3.6%	100,000	6.8%		
Expenses deducted in the accounts which have no corresponding deduction for income taxes	276,996	1.5%	665,323	45.1%	168,476	2.1%
Impact of different tax rate on earnings of foreign subsidiaries	(483,406)	(2.5)%	(185,524)	(12.6)%	(111,815)	(1.4)%
Change in valuation allowance	2,407,144	13.3%				
Other	(555,217)	(3.1)%	152,662	10.4%	(224,945)	(2.9)%
	$(4,853,540)	(26.7)%	$1,359,731	92.2%	$3,252,354	41.9%

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

13. Income taxes (continued):

The tax effects of temporary differences that give rise to significant portions of the future tax assets and liabilities at September 30, 2002 and 2001 are presented below:

	2002	2001
Future tax assets:		
Capital assets	$1,263,019	$ 333,006
Share issuance costs	422,369	530,891
Non-capital losses expiring in 2009 (2001 - 2009)	3,890,104	712,000
Other	189,845	
	5,765,337	1,575,897
Less valuation allowance	2,407,144	
Net future tax assets	3,358,193	1,575,897
Future tax liabilities:		
Goodwill	43,965	41,741
Total net future tax assets	3,314,228	1,534,156
Less current portion	855,000	712,000
	$2,459,228	$ 822,156

At September 30, 2002, the Company has non-capital losses of approximately $9,340,000 available to reduce future years taxable income, which expire as follows:

2008	$3,175,000
2009	6,165,000
	$9,340,000

The Company also has non-capital losses available for carryforward for United States State and City tax purposes amounting to approximately $8,000,000, expiring in 2022.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

14. Unusual items:

During 2002, as a result of changes in the banking loan arrangements, the Company was no longer allowed to fully utilize its line of credit and, accordingly, the remaining unamortized portion of deferred financing charges totalling $750,648 were written off.

During 2001, the Company announced that it was terminating its discussions in connection with the proposed acquisition of Leagas Delaney. Generally accepted accounting principles require that the $1,917,334 of costs incurred in connection with the proposed acquisition and the related equity financing be expensed in full as of the date of abandonment. Costs include legal, accounting, consulting and other out-of-pocket expenses incurred in the negotiation and preparation of legal documents and preparation of long-form prospectus materials prepared in connection with the abandoned acquisition.

15. Restructuring costs:

In response to a general economic downturn impacting the Company s business, management implemented a restructuring plan during the first half of this fiscal year in order to bring costs more in line with expected revenues. The restructuring involved downsizing its workforce, exiting excess office space and writing off redundant fixed assets. Accordingly, the Company has recorded a restructuring expense of $10,857,534. The restructuring includes a reduction of staff, as well as the abandonment of leased office space in New York City. As part of the settlement with the landlord, the Company issued 250,000 common shares with a cost of $52,500.

	Cash	Non-cash	Total provision	Provision, September 30, 2002
Severance	$3,268,261	$	$ 3,268,261	$1,013,424
Write-down of capital assets		3,481,105	3,481,105	
Lease exit costs	4,055,668	52,500	4,108,168	1,481,196
Total restructuring charge	$7,323,929	$3,533,605	$10,857,534	$2,494,620

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

15. Restructuring costs (continued):

Total restructuring costs accrued at September 30, 2002 are classified as:

Accounts payable and accrued liabilities	$ 1,702,345
Long-term portion of restructuring costs	792,275
	$ 2,494,620

16. Commitments and contingencies:

(a) The Company has entered into operating lease agreements for office premises and equipment with minimum annual lease payments over the next five years as follows:

2003	$ 4,402,963
2004	4,036,683
2005	3,840,998
2006	3,253,230
2007	8,932,271
Thereafter	77,213
	$24,543,358

Rent expense under operating leases for the year ended September 30, 2002 amounted to $2,041,417 (2001 - $1,980,592; 2000 - $1,680,822).

(b) The Company has letters of credit outstanding of Cdn. $150,000, U.S. $500,000 and £250,000 all of which expire on April 30, 2003.

(c) The shares held by the minority shareholders of John Street Inc., representing a 30% interest, are mandatorily redeemable by the Company at September 30, 2004 for cash consideration and as such represents a financial liability of the Company. No amount has been accrued in the financial statements as the purchase price will be determined and paid over a three-year period based on certain performance milestones.

(d) In the ordinary course of business, the Company and its subsidiaries have legal proceedings brought against them. Management does not expect the outcome of these proceedings, in aggregate, to have a material adverse effect on the Company s consolidated financial position or results of operations.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

17. Financial instruments:

The estimated fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than a forced or liquidation sale. These estimates, although based on the relevant market information about the financial instrument, are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

(a) The carrying values and estimated fair values of the Company s financial instruments are as follows:

(i) The carrying amounts of cash, restricted cash, accounts receivable, accounts payable and accrued liabilities and promissory note approximate their fair values due to the short-term nature of these instruments.

(ii) The fair value of the Company s bank credit facility approximates its carrying value as it bears an interest rate that is at the current market rate.

(iii) The fair values of the Company s long-term obligations and convertible debentures are estimated using discounted cash flow analysis which is based on the Company s current incremental borrowing rates for similar types of borrowing arrangements. The carrying values of the capital leases and convertible debentures are not significantly different from their fair values.

As at September 30, 2002, the carrying value of the loans payable to landlords was $900,959 (2001 $1,083,323) and their fair value was $671,000 (2001 $1,083,323).

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

17. Financial instruments (continued):

(iv) The fair value of foreign currency contracts are estimated by obtaining quotes of the amount that the Company would have to pay counterparties to terminate agreements. As at September 30, 2001, the carrying amounts of the contracts were ($104,218) and their fair values were ($189,224). The Company had no such contracts as at September 30, 2002.

(b) Risk management activities:

(i) Currency risk:

The Company is subject to currency risk through its activities in the United States and the United Kingdom. Unfavourable changes in the exchange rate may affect the operating results of the Company. The Company does not actively use derivative instruments to reduce its exposure to foreign currency risk. However, dependent on the nature, amount and timing of foreign currency receipts and payments, the Company may enter into foreign currency contracts to mitigate the associated risks. As at September 30, 2002, there were no foreign currency contracts outstanding.

At September 30, 2002, the Company had U.S. $2,002,704 (Cdn. $3,178,691) outstanding on the U.S. portion of the bank credit facility. Prior to June 30, 2002, the U.S. dollar borrowings were designated as a hedge against the Company s investment in its U.S. operations, managing exposure to foreign currency risk. Commencing July 1, 2002, the Company no longer hedged Watt s U.S. dollar receivables with foreign currency contracts and thus, the Company s U.S. dollar borrowings are now a hedge of such receivables.

The Company s promissory note payable issued in connection with its acquisition of Gilchrist (note 3(c)) serves as a hedge against the Company s investment in its U.K. operations, managing exposure to foreign currency risk.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

17. Financial instruments (continued):

(ii) Credit risk:

The Company manages its credit risk with respect to accounts receivable by acting as an agent for its customers, by dealing primarily with large creditworthy customers and by billing whenever possible in advance of rendering services. As at September 30, 2002, the Company has one customer, which represents 11% of accounts receivable (2001 one customer which represents 18% of accounts receivable).

The Company is exposed to credit risk in the event of non-performance by counterparties in connection with its foreign currency contracts. The Company does not obtain collateral or other security to support financial instruments subject to credit risk but mitigates this risk by dealing with financially sound counterparties only and, accordingly, does not anticipate loss for non-performance.

18. Segmented information:

The Company provides integrated marketing communication services to its clients. While the Company has subsidiaries in Canada, the United States, the United Kingdom and Continental Europe, it operates as an international business and has no distinct reportable business segments.

The tables below set out the following information:

(a) The Company s external net revenue by geographic region based on the region in which the customer is located is as follows:

	2002	2001	2000
Net revenue:			
Canada	$15,982,433	$21,826,277	$24,164,713
United States	27,708,424	40,970,400	32,559,550
United Kingdom and Continental Europe	15,430,233	19,988,864	4,066,017
	$59,121,090	$82,785,541	$60,790,280

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

18. Segmented information (continued):

(b) The Company s identifiable assets for each geographic area in which it has operations are as follows:

	2002	2001
Capital assets:		
Canada	$5,363,424	$ 7,997,668
United States	261,566	1,316,098
United Kingdom and Continental Europe	2,211,738	2,219,970
	$7,836,728	$11,533,736

	2002	2001
Goodwill:		
Canada	$ 3,087,766	$21,956,307
United States		19,706,227
United Kingdom and Continental Europe	8,226,517	8,012,581
	$11,314,283	$49,675,115

(c) The Company s external net revenue by type of service is as follows:

	2002	2001	2000
Net revenue:			
Marketing	$12,428,558	$24,374,986	$28,772,421
Design	38,203,746	43,437,449	24,431,398
Technology	8,488,786	14,973,106	7,586,461
	$59,121,090	$82,785,541	$60,790,280

(d) In 2002, the Company had three customers, which represented 19%, 12% and 12% of net revenue. In each of 2001 and 2000, the Company had two customers which represented 13.6% and 11.3% of net revenue, respectively.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

19. Subsequent events:

(a) In October and November 2002, the Company sold the operations of Devlin and Sage to certain executives of the respective subsidiaries in exchange for cash proceeds of approximately $330,000. In addition to the cash payment on the sale of Sage, the Company is entitled to a fee on sales to certain former customers of Sage.

(b) In December 2002, the Company established a $500,000 line of credit with a new lender and borrowed the full amount of the facility. The loan is repayable on June 30, 2003 and bears interest at a rate of 15% per annum. The net proceeds of the loan were used for purposes of providing working capital. The loan is secured by a general security agreement against the assets of the Company subordinated to the borrowings under the existing bank credit facilities, capital leases and the convertible debentures.

20. Reconciliation to United States generally accepted accounting principles:

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) as applied in Canada. Set out below are the material adjustments to net earnings (loss) for the years ended September 30, 2002, 2001 and 2000 required in order to conform to U.S. GAAP.

	2002	2001	2000
	(Restated - note 20(l))		
Net earnings (loss) based on Canadian GAAP	$(53,379,435)	$(2,895,372)	$2,910,427
Stock-based compensation expense (a)		(886,000)	
Foreign currency contracts, net of income tax recovery of $35,703 (d)	49,303	(49,303)	
Convertible debentures (e)	(46,100)		
Net earnings (loss) based on U.S. GAAP	$(53,376,232)	$(3,830,675)	$2,910,427
Earnings (loss) per share:			
Basic	$ (2.54)	$ (0.18)	$ 0.15
Diluted	(2.54)	(0.18)	0.15

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

20. Reconciliation to United States generally accepted accounting principles (continued):

The following adjustments are required in order to conform shareholders equity based on Canadian GAAP to shareholders equity based on U.S. GAAP:

	2002	2001
	(Restated - note 20(l))	
Shareholders equity based on Canadian GAAP	$9,779,169	$61,319,385
Foreign currency contracts, net of income tax recovery of $35,703 (d)		(49,303)
Convertible debentures (e)	(578,603)	
Shareholders equity based on U.S. GAAP	$9,200,566	$61,270,082

Summary of accounting policy differences:

The areas of material difference between Canadian and U.S. GAAP and their impact on the consolidated financial statements of the Company are set out below:

(a) Stock-based compensation expense:

U.S. GAAP requires the Company to record compensation expense when modifications are made which extend the lives of options. During the year ended September 30, 2001, the Company extended the life of an individual s option award and has therefore recorded the intrinsic value of the option at the date of the extension as compensation expense.

(b) Business combinations:

U.S. GAAP requires the disclosure of the unaudited pro forma U.S. GAAP consolidated results of operations for the year ended September 30, 2000 giving effect to the acquisition of Gilchrist as if it had occurred as of October 1, 1999 which are as follows:

Net revenue	$68,242,235
Net earnings	2,602,527
Basic net earnings per share	0.14
Diluted net earnings per share	0.13

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

20. Reconciliation to United States generally accepted accounting principles (continued):

U.S. GAAP requires the disclosure of the unaudited pro forma U.S. GAAP consolidated results of operations for the year ended September 30, 2000 giving effect to the acquisition of Sage as if it had occurred as of October 1, 1999 which are as follows:

Net revenue	$63,102,395
Net earnings	950,950
Basic net earnings per share	0.05
Diluted net earnings per share	0.05

(c) Stock-based compensation disclosures:

The Company measures compensation expense relating to employee stock option plans for U.S. GAAP purposes using the intrinsic value method specified by APB Opinion No. 25, which in the Company s circumstances would not be materially different from compensation expense as determined under Canadian GAAP, except as disclosed in note 20(a).

Had the Company determined compensation costs based on the fair value at the grant date of its stock options consistent with the method prescribed under Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 123 (SFAS 123), the Company s net earnings (loss) and earnings (loss) per share would have been reported as the pro forma amounts indicated below:

	2002	2001	2000
	(Restated - note 20(l))		
Net earnings (loss) in accordance with U.S. GAAP as reported	$(53,376,232)	$(3,830,675)	$2,910,427
Pro forma net earnings (loss)	(54,353,655)	(4,719,780)	1,853,385
Pro forma basic earnings (loss) per share	$ (2.59)	$ (0.22)	$ 0.10
Pro forma diluted earnings (loss) per share	(2.59)	(0.22)	0.09

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

20. Reconciliation to United States generally accepted accounting principles (continued):

Pro forma net earnings (loss) reflect only those options granted during the seven years ended September 30, 2002. Therefore, the full impact of calculating compensation costs for stock options under SFAS 123 is not reflected in the pro forma net earnings amounts presented above because compensation cost is reflected over the expected lives of the options and the compensation cost for options granted prior to October 1, 1995 is not considered. The notional compensation expense associated with the Company s options is not deductible for Canadian income tax purposes. Accordingly, the full amount of compensation expense is reflected in the pro forma figures above, without any related tax recovery.

The weighted average estimated fair value at the date of the grant, as defined by SFAS 123, for options granted in fiscal 2002 was $0.16 per share (2001 - $2.39; 2000 -$3.07).

The fair value of each option granted was estimated on the date of the grant using the Black-Scholes fair value option pricing model with the following assumptions:

	2002	2001	2000
Risk-free interest rate	4.00%	4.70%	4.70%
Dividend yield			
Volatility factor of the future expected market price of the Company s common shares	76%	65%	60%
Weighted average expected life of the options	1.36 years	2.33 years	2.56 years

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected price volatility. Because the Company s employee share options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee share options.

For the purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options vesting period on a straight-line basis.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

20. Reconciliation to United States generally accepted accounting principles (continued):

(d) Derivative financial instruments:

The Company enters into forward contracts to manage its exposure to fluctuations in foreign exchange rates. Effective October 1, 2000, the Company adopted the provisions of FASB Statement No. 133, Accounting For Derivatives and Hedging Activities. SFAS No. 133 requires that all derivatives be recognized as assets and liabilities on the balance sheet and measured at fair value. Hedge accounting is only applied to derivatives if the hedging relationship has been identified, and the Company has formally documented the designation of the hedging relationship and the method for assessing the effectiveness of the hedging relationship. Both at inception of the hedging relationship and throughout its term, the relationship must be effective in achieving offsetting changes in the cash flows of the hedged item.

Under SFAS No. 133 for derivatives designated and effective as hedges of future cash flows, changes in the fair value of the derivative are recognized in other comprehensive income, with no impact on net earnings until the hedged item is recognized in earnings. To the extent the hedge is ineffective, or not designated or documented as a hedge, the change in fair value of the hedge would be recognized in earnings each period. During 2001, the Company had not designated and documented its foreign exchange contracts as a hedge of future cash flows and, therefore, must record the change in fair value as a charge against earnings.

Under Canadian GAAP, no accounting recognition is given to the fair value of those forward contracts which are a hedge of future cash flows. As at September 30, 2001, the fair value of foreign exchange forward contracts, which were otherwise designated as a hedge of future cash flows for Canadian GAAP, totalled ($85,006). This amount represents an additional liability under U.S. GAAP, and this amount net of the related tax recovery is recorded as a charge to U.S. GAAP net earnings.

As at September 30, 2002, there were no foreign currency contracts outstanding.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

20. Reconciliation to United States generally accepted accounting principles (continued):

(e) Convertible debentures:

During 2002, the Company issued $3.8 million in convertible debentures. The debentures are convertible at any time at the option of the holder into common shares and common share purchase warrants of the Company (note 11). Under Canadian GAAP, the debentures are bifurcated into a debt component and an equity component, based on relative fair values, which resulted in aggregate proceeds of $1,949,628 allocated to long-term debt and $1,850,372 to shareholders equity, respectively for the aggregate $3.8 million debentures. Under Canadian GAAP, the discount resulting from allocating proceeds to the equity component must be recorded as an additional interest expense, using an effective yield method, over the minimum period to redemption being two years. As a result of accreting the debentures, $133,870 has been charged as interest expense for 2002. Under Canadian GAAP, issue costs are allocated between the debt and equity components which resulted in $129,513 of the aggregate $262,465 issue costs being applied to reduce the equity allocation.

Under U.S. GAAP, any excess of the fair value of the shares over the proceeds allocated to the common share portion of the conversion price is considered a beneficial conversion feature. For the two debentures issued during 2002, an aggregate beneficial conversion feature of $1,188,356 must be recorded as interest expense over the minimum period to the earliest redemption date. Although the debentures have a five-year life, the holder has the option to demand repayment at the second anniversary date, therefore such amount must be expensed over the two-year term. Accordingly, $168,541 is recorded as interest expense under U.S. GAAP. Under U.S. GAAP, costs associated with issuance of the debentures cannot be apportioned between the debt and equity components. Accordingly, deferred financing fees under U.S. GAAP would be $129,513 higher, for which $11,429 would be amortized in the current period.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

20. Reconciliation to United States generally accepted accounting principles (continued):

(f) Comprehensive income:

The Company s comprehensive income represents U.S. GAAP net earnings plus the change in the cumulative translation adjustment account in respect of foreign operations as follows:

	2002	2001	2000
	(Restated - note 20(l))		
Net earnings (loss) for the year in accordance with U.S. GAAP	$(53,376,232)	$(3,830,675)	$2,910,427
Change in cumulative translation adjustment account	515,569	1,147,208	180,516
	$(52,860,663)	$(2,683,467)	$3,090,943

(g) Reduction of capital:

In 1997, the share capital of the Company was reduced by $9,886,961 pursuant to a special resolution of its shareholders and was applied against the deficit. This reduction in capital is not permitted under U.S. GAAP. While the adjustment has no impact on shareholders equity, under U.S. GAAP, capital stock would be increased by $9,886,961 and retained earnings would be decreased by $9,886,961 as at September 30, 2002 and 2001.

(h) Statements of cash flows:

The Company has disclosed cash flows from operations per share, which is not permitted under U.S. GAAP.

(i) Other disclosures:

U.S. GAAP and the United States Securities and Exchange Commission require the Company to disclose the following items, for which disclosure is not required under Canadian GAAP:

(i) The allowance for doubtful accounts as at September 30, 2002 was $226,037 (2001 - $1,432,668).

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

20. Reconciliation to United States generally accepted accounting principles (continued):

(ii) As at September 30, 2002, the Company had a nil (2001 - $32,158,672) unused line of credit.

(iii) U.S. GAAP requires the disclosure of accrued liabilities. Accrued liabilities included in accounts payable and accrued liabilities as at September 30, 2002 were $4,779,517 (2001 - $6,330,821). As at September 30, 2002, Envoy had accrued $1,122,745 for the termination of certain leased premises of Hampel Stefanides. At September 30, 2001, accrued liabilities include $2,263,266 related to additional consideration for the acquisition of Hampel Stefanides (note 3(e)).

At September 30, 2002, there were no other accrued liabilities that exceeded 5% of current liabilities.

(iv) The Company has disclosed both net earnings before goodwill amortization and net earnings per share before goodwill amortization, which are not permitted disclosures under U.S. GAAP.

(j) Restructuring charges:

Under U.S. GAAP restructuring charges would be included as operating expenses in the consolidated statement of operations.

(k) Recent accounting pronouncements:

(i) In October 2001, the FASB issued SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This statement supersedes SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of and related literature and establishes a single accounting model, based on the framework established in SFAS No. 121, for long-lived assets to be disposed of by sale. The Company is required to adopt SFAS No. 144 for its fiscal year beginning October 1, 2002. The Company has not determined the impact of the adoption of SFAS No. 144 on its consolidated financial statements.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

20. Reconciliation to United States generally accepted accounting principles (continued):

(ii) In September 2001, the CICA issued Handbook Sections 1581, Business Combinations and 3062, Goodwill and Other Intangible Assets. The new standards mandate the purchase method of accounting for business combinations and require that goodwill no longer be amortized but instead be tested for impairment at least annually. The standards also specify criteria that intangible assets must meet to be recognized and reported apart from goodwill. The standards require that the value of the shares issued in a business combination be measured using the average share price for a reasonable period before and after the date the terms of the acquisition are agreed to and announced. Previously, the consummation date was used to value the shares issued in a business combination. The new standards are substantially consistent with United States GAAP.

Under the new standards for Business Combinations, effective July 1, 2001, goodwill acquired in business combinations completed after June 30, 2001 is not amortized. In addition, the criteria for recognition of intangible assets apart from goodwill and the valuation of the shares issued in a business combination must be applied to business combinations completed after June 30, 2001.

The Company is required to adopt the new standards for goodwill and other intangible assets effective October 1, 2002, at which time, the Company will discontinue amortization of all existing goodwill and test for impairment in accordance with the new standards.

In connection with transitional goodwill impairment evaluation, as specified in the new standard, the Company is required to assess whether goodwill is impaired as of October 1, 2002. The Company has up to six months to determine the fair value of its reporting units and compare that to the reporting units carrying amounts. To the extent a reporting unit s carrying amount exceeds its fair value, the Company must perform a second step to measure the amount of impairment in a manner similar to a purchase price allocation. This second step is to be completed no later than September 30, 2003. Any transitional impairment will be recognized as an effect of a change in accounting principle which under Canadian GAAP, is recorded as a charge to opening retained earnings as of October 1, 2002.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

20. Reconciliation to United States generally accepted accounting principles (continued):

As of September 30, 2002, the Company had unamortized goodwill of $11,421,498, other than $455,607, resulting from an acquisition during 2002 which is not being amortized and is subject to the transitional provisions of Sections 1581 and 3062. Amortization expense related to goodwill was $2,211,509 for 2002. Because of the extensive effort required to comply with the remaining provisions of Sections 1581 and 3062, the Company has not estimated the impact of these provisions on its financial statements, beyond discontinuing goodwill amortization.

(iii) In August 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations . This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and for the associated asset retirement costs. SFAS No. 143 is effective for the Company s fiscal year beginning October 1, 2002. The Company does not believe that the adoption of SFAS No. 143 will have a material impact on its consolidated financial statements.

(iv) Effective October 1, 2002, the Company will adopt the new Canadian accounting standard for stock-based compensation and other stock-based payments. The new standards will require additional disclosures for options granted to employees and that a compensation cost be recorded for the fair value of options granted to non-employees and awards to employees that call for settlement in cash or other assets, including stock appreciation rights. The new standards for non-employees will be similar in many respects to SFAS No. 123. The Company does not believe that the adoption of these standards will have a material impact on its consolidated financial statements.

(v) Effective October 1, 2003, the Company will be required to adopt the new Canadian Accounting Guideline, Hedging Relationships , that establishes standards for the documentation and effectiveness of hedging relationships that are substantially similar to the corresponding requirements in SFAS No. 133. The Company does not believe that the adoption of these standards will have a material impact on its consolidated financial statements.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

20. Reconciliation to United States generally accepted accounting principles (continued):

(vi) In December 2002, the CICA issued Handbook Section 3063, Impairment of Long-Lived Assets , and revised Section 3475, Disposal of Long-Lived Assets and Discontinued Operations . These new rules supersede the write-down and disposal provisions of CICA Handbook Section 3061, Property, Plant and Equipment , as well as current Handbook Section 3475, Discontinued Operations . The new standards are based on SFAS 144. Under revised Handbook Section 3475, new standards are established for the recognition, measurement, presentation and disclosure of the disposal of long-lived assets as well as for the presentation and disclosure of discontinued operations. New Handbook Section 3063 establishes standards for the recognition, measurement and disclosure of the impairment of long-lived assets held for use. Under the new standards, an impairment loss is recognized when the carrying amount of an asset held for use exceeds the sum of the undiscounted cash flows expected from its use and eventual disposition. An impairment loss is measured as the amount by which the asset s carrying amount exceeds its fair value.

The new accounting recommendations contained in Handbook Section 3063 on the impairment of long-lived assets held for use should be applied for years beginning on or after April 1, 2003. The revised accounting recommendations contained in Handbook Section 3475 on disposal of long-lived assets and discontinued operations should be applied to disposal activities initiated by a company s commitment to a plan on or after May 1, 2003. The Company has not determined the impact of the adoption of these standards on its consolidated financial statements.

Table of Contents

ENVOY COMMUNICATIONS GROUP INC.
Notes to Consolidated Financial Statements (continued)
(Expressed in Canadian dollars)

Years ended September 30, 2002, 2001 and 2000

20. Reconciliation to United States generally accepted accounting principles (continued):

(l) Restatement:

Shareholders equity and net loss for the year based on U.S. GAAP as at, and for the year ended September 30, 2002 differ from the amounts previously reported as the Company previously expensed the beneficial conversion associated with its convertible debentures, as described in note 20(e), totalling $1,188,356, immediately. However, this amount should have been amortized over the two-year term of the debentures which would reduce the charge in 2002 to $168,541, resulting in a decrease to net loss for the year based on U.S. GAAP of $1,019,815. The effect of this restatement to basic and diluted loss per share for the year ended September 30, 2002 was as follows:

U.S. GAAP basic loss per share:	
As previously reported	$(2.59)
Restated	(2.54)
U.S. GAAP diluted loss per share:	
As previously reported	$(2.59)
Restated	(2.54)