

REPORTED CANADIAN/US GAAP DIFFERENCES

Summary of Survey of Canadian Annual Reports for Years Ending in 2006

I – Introductory Comments

This report analyzes the results of reported Canadian/US GAAP differences in a survey of 150 public Canadian companies for fiscal years ending in 2006. All of the companies selected for this study have listings on major US stock exchanges or issue debt securities in the US.

The Accounting Standards Board (AcSB) has adopted a Strategic Plan that calls for the convergence over time of Canadian standards for publicly accountable enterprises with International Accounting Standards Board (IASB) standards. The AcSB will work to eliminate the remaining significant differences with US generally accepted accounting principles (GAAP) when their elimination is consistent with the IASB convergence objective, and it intends to avoid creating new differences with US GAAP whenever possible. However, some differences with US GAAP may be unavoidable as a result of the AcSB's Strategic Plan, but such differences should generally be temporary because the US Financial Accounting Standards Board (FASB) and the IASB are working together to converge their standards.

Consistent with IASB objectives, the AcSB seeks to avoid excessively detailed “rules-based” standards, instead requiring that reporting entities and their auditors exercise professional judgment. In a number of areas, the AcSB has deliberately chosen not to adopt more extensive implementation guidance and “bright line” tests often found in US GAAP, particularly when they are not found in IASB standards. This means there will continue to be some differences in the application of US and Canadian GAAP, including areas where the standards in both countries are based on the same fundamental principles (“harmonized”). Furthermore, for various reasons explained below, the relative significance of specific differences can vary from year to year as economic conditions change and standards in both countries continue to evolve.

The primary purposes of this survey are:

- to identify new or unintended differences with US GAAP; and
- to assist the AcSB in determining the status of continuing differences.

Appendix 1 sets out a summary analysis of Canadian/US GAAP differences by topic.

II – The Companies – Basis for Selection

The 150 surveyed public Canadian companies were selected as follows:

- the largest 200 Canadian public companies by asset size (as reported in the most current Financial Post “FP 500”) that were SEC registrants (60 companies); and
- a sample of additional Canadian companies listed on the NYSE, NASDAQ or AMEX (90 companies). To the extent possible, companies included in last year’s survey were selected for the 2006 survey, in order to maintain year-to-year comparability.

19 companies in the 2005 survey had to be replaced in 2006 because they no longer had shares traded in the US (seven companies delisted their shares and twelve companies were acquired by, and absorbed within, other companies). In selecting replacement companies, an attempt was made to maintain the proportional representation of companies by industry. For the purposes of this study, the industry classifications assigned by the System for Electronic Document Analysis (SEDAR) were used.

This is the ninth annual survey. The basis for identifying and classifying reported GAAP differences is consistent with surveys conducted since 2000.

III – Accounting Basis (Canadian or US GAAP) and Provision of Reconciliations

40 companies (2005 – 36 companies) provided only US GAAP financial statements in their published annual reports.¹ 24 of them (10 in 2005 and 9 in 2004) did not provide GAAP difference reconciliations.

Of the 126 companies reporting Canadian/US GAAP differences (150 minus 24 that did not provide reconciliations), 114 provided reconciliations in the notes to their financial statements, and 12 provided reconciliations only in SEC filings.

Reporting Currency

77 of the 150 companies (51%) presented their financial statements in US dollars in both 2006 and 2005. There has been a significant increase in the number of companies reporting in US dollars over the years to 2005 (2004 – 67 out of 150 companies, 45%; and 2003 – 56 out of 150 companies, 37%).

¹ Effective March 30, 2004, Canadian Securities Administrators (CSA) permit Canadian companies registered with the SEC to prepare their financial statements in accordance with US GAAP in lieu of Canadian GAAP. These companies are required by CSA regulations to provide reconciliations to Canadian GAAP as notes to their financial statements for two years following the adoption of US GAAP. After this period, these companies are under no obligation to provide reconciliations to Canadian GAAP.

IV – Quality of Reconciliation Information

The quality of reconciliation information varied significantly. Some companies provided reconciliations that were well presented and included reasonably detailed information about the differences and, when relevant, their effects on net income. However, some others provided information that was overly summarized or included complex notes that were difficult to analyze. Some provided explanations that were incomplete or not clearly referenced to the applicable differences and their income effects. In a few cases, no reasonable basis could be determined for classifying one or more differences.² While these problems did not have a major effect on the overall results, they appear to be more common in recent surveys.

No attempt was made to evaluate the appropriateness of the interpretations and applications of either Canadian or US GAAP as expressed or implied by the reconciliations.

V – Analysis of Reported Differences – General Comments

The 126 companies reporting Canadian/US GAAP differences identified a total of 559 differences, which averages 4.4 differences per company. (In 2005, 140 companies reported 603 differences averaging 4.3 differences per company). There are several reasons for the persistence of a significant number of reported differences. Primary among these are:

- Several standards issued by the AcSB that harmonize Canadian GAAP with US GAAP were not yet effective.
- A number of transitional differences persisted with respect to harmonized standards that were in effect, and some transitional differences continue for many years.

In addition, some differences in business circumstances and economic conditions have significantly affected the number of reported differences in individual years.

The following differences were particularly significant in 2006:

- The largest number of reported differences related to accounting for financial instruments, investments and hedges. These were the result of:
 - SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, and subsequent amendments, which were first effective for most companies' 2001 financial statements (70 companies reported differences resulting from these standards in 2006); and
 - SFAS 115, *Accounting for Certain Debt and Equity Securities*, which has been in effect since 1994 (39 companies reported differences from this standard in 2006).

² For example, some companies reported only one aggregate income tax difference. In a few of these cases, no reasonable assumptions could be made as to whether, and to what extent, the difference related to the tax effects of other differences or to one or more differences in accounting for income taxes. These were classified as unexplained tax differences.

Canadian standards have been harmonized with these US standards effective for years beginning on or after October 1 2006, so a significant reduction in these differences may be expected in 2007 financial statements (subject to the persistence of transitional effects).

- 59 companies reported differences in accounting for pensions and other employee benefits in 2006. The most significant cause (45 differences) resulted from under-funded defined benefit pension plans and the requirement under US, but not Canadian, GAAP to record an additional net liability in respect of accumulated unfunded pension obligations.
- 56 reported differences relate to employee stock compensation. Canadian and US standards are now largely harmonized. However, differences in mandatory effective dates and complex transitional provisions allow companies a wide variety of retroactive or prospective alternatives for adoption under both standards.
- 66 companies reported cost deferral differences (including start-up costs and R&D). All but a few of these differences represent costs that can be deferred under Canadian GAAP but are to be expensed under US GAAP. There is a basic difference in principle between the two countries on cost deferrals, particularly in respect of development costs. Canadian GAAP has been closer in principle to IASB standards, although acceptance in Canada for deferral of certain start-up costs seems to go beyond what is accepted under IASB standards.
- 42 differences were reported in 2006 with respect to debt/equity classification. On the one hand, an amendment in 2004 to Canadian standards on obligations that can be settled by the issuer with its own equity instruments has eliminated some differences with US GAAP. On the other hand, there has been an increase in reported differences relating to the classification of income trust units, some preferred shares that are not subject to mandatory redemption, and certain types of share purchase warrants. As well, a number of companies continue to report differences resulting from separating issued convertible securities into equity and debt components under Canadian GAAP that are treated wholly as debt under US GAAP. The FASB is leading a project on liability/equity classification issues with the objective of developing converged standards with the IASB, but resolution of these issues seems unlikely in the short to medium term.

The following is the range of reported differences per company between 2001 and 2006:

Number of companies	2006	2005	2004	2003	2002	2001
Reported no differences	4	2	6	6	6	6
Reported 1-3 differences	51	59	50	37	40	40
Reported 4-6 differences	47	55	55	53	57	53
Reported 7-9 differences	13	14	22	34	27	31
Reported 10 or more differences	11	10	8	8	3	3
Total number of companies	126	140	141	138	133	133

Prior to 2002, approximately two-thirds of the companies providing reconciliations reported higher income under Canadian GAAP than under US GAAP. This has been declining since then,

and in 2005 and 2006 there was roughly an even split between the number of companies reporting higher income and the number of companies reporting lower income under US GAAP.

In 2006, approximately 64 percent of the individual differences are less than five percent of reported Canadian GAAP net income. Of course, the combined effect of several immaterial individual items can be material, and some differences that are not material to reported income have significant balance sheet effects. No attempt has been made to examine the materiality of balance sheet effects.

Comparison with IASB Standards

A significant number of the reported differences with US GAAP would not be differences with existing IASB standards. These include approximately 140 differences relating primarily to accounting for joint ventures, pensions, R&D, and debt/equity classification. There are likely more, but it is not possible to make an assured determination of them on the basis of available information.

In addition, approximately 160 reported differences (related to financial instruments and stock-based compensation, all of which are also differences with IASB standards) will not be differences from IASB standards when Canadian standards become fully effective and there are no longer transitional differences.

It is emphasized that IASB standards differ in some respects from both Canadian and US GAAP, so additional differences would be reported if the surveyed companies were to prepare reconciliations between Canadian or US GAAP and IASB standards.

Voluntary Differences

A number of the reported differences are voluntary — that is, companies could have chosen a Canadian GAAP alternative that conformed to US GAAP but chose to be different. For example, nine companies reported that they chose not to follow US standards for interest capitalization in 2006. Although some voluntary differences are reasonably evident, many differences are not described in sufficient detail to enable determining whether they are voluntary. In particular, the voluntary vs. conflict nature of differences relating to cost deferrals is difficult to assess, although it would appear that many of them are likely voluntary. Also, most of the differences relating to stock compensation seem likely to be voluntary. No attempt has been made to estimate the number or proportion of voluntary differences.

Differences that Will Be Eliminated

A large number of reported differences will be eliminated in future years as a result of:

- completed accounting standards that harmonize Canadian standards with US GAAP but did not come fully into effect in the current year or for which transitional effects persist; and
- current or planned projects to harmonize Canadian and US GAAP.

Appendix 2 sets out an analysis, including a rough estimate of the number of Canadian/US GAAP differences reported in 2006 that may be expected to be eliminated in future years as a consequence of more significant standard-setting projects being completed or underway. They comprise close to 45 percent of the reported differences. It is to be noted, however, that some differences will persist for some time where there are transitional effects resulting from changes in standards. Reported differences that are not the subject of current AcSB projects to harmonize standards with US GAAP include differences relating to:

- interest capitalization;
- investments in certain limited partnerships;
- foreign currency translation effects of reductions in certain foreign operations;
- R&D;
- the over- and under-funded status of defined benefit pension plans;
- pension asset allowances;
- life insurance;
- extractive industry reserves and impairment provisions;
- “fresh start” accounting for certain restructurings;
- revenue recognition;
- debt/ equity classification; and
- some consolidation/ equity accounting matters.

The AcSB is looking to the IASB and international convergence projects in a number of these areas. These projects may improve upon US standards and may, in some cases, move closer to existing Canadian standards than existing US GAAP.

Appendix 1 Summary Analysis of Canadian/US GAAP Differences by Topic

Topic	Total reported	Immaterial income effect ¹	Transition ²	In process ³	Other	Comments on items reported in the “in process” and “other” columns
Foreign currency translation	22	15		1	6	In process – hedge accounting. Other – net investments in foreign operations and unexplained foreign currency differences.
Stock compensation	56	39*	17			
Impairment of long-lived assets	19	10	3		6	Other – oil and gas properties.
Business combinations	11	6	1	3	1	In process – valuation of assets and liabilities of acquired companies on acquisition. Other – regulated company difference.
Pensions and other employee benefits	59	34	3		22	Other – under/over funded pension liabilities/assets, and pension asset allowance.
Income taxes	35	20	1	2	12	In process – use of “substantially enacted” legislation in Canada. Other – aggregated and unexplained differences.
Financial instruments and hedging	70	41*	29			
Debt/equity classification	42	17 **			25	The issues are being addressed in an FASB/IASB project.
Consolidation/ equity method	20	16			4	Other – non-controlling interests, limited partnerships, and push-down accounting.

* These immaterial items are largely transitional effects or will be eliminated as a result of issued AcSB standards.

** These items do not affect or have an immaterial effect on reported income but many of them may materially affect one or more of assets, liabilities, equity classifications, revenues and expenses.

¹ Items affecting reported Canadian GAAP income by less than five percent. Some have material balance sheet effects; this survey has not attempted to analyze balance sheet effects.

² Standards that are now harmonized by action taken by the AcSB and/or FASB but are either not yet in effect in both countries or are transitional effects from periods prior to the change. A few differences may arise where Canadian standards allow alternatives not permitted under US GAAP.

³ Active or imminent projects of the AcSB.

Topic	Total reported	Immaterial income effect	Transition	In process	Other	Comments on items reported in the “in process” and “other” columns
Joint ventures	27	25**			2	Canada is unique in requiring proportionate consolidation (subject of an AcSB project). Other – income on contributions to joint ventures, and differences in accounting within joint ventures.
Restructurings	7	2			5	Other – “fresh start” accounting, and reorganizations.
Liabilities	11	9			2	Other – life insurance (targeted for global project).
Capitalized interest	9	7			2	Voluntary difference.
Cost deferrals	44	32		4	8	In process – deferred start-up costs (subject of the AcSB internal intangibles project). Other – mining and life insurance, which are subjects of global projects.
Investments – cost/fair value	39	22*	17			
PP&E and depreciation	11	3	2		6	Other – mining reserves, which are subject of a global project, and when depreciation begins.
R&D	18	14			4	Canadian GAAP similar to IASB and arguably superior to US GAAP.
Shareholders’ equity	16	15**			1	Other – flow-through shares.
Revenue recognition	12	5			7	Other – life insurance and sales of property.
Other	31	28	1		2	Other – a related party transaction.

* These immaterial items are largely transitional effects or will be eliminated as a result of issued AcSB standards.

** These items do not affect or have an immaterial effect on reported income but many of them may materially affect one or more of assets, liabilities, equity classifications, revenues and expenses.

Appendix 2

Canadian/US GAAP Differences that Are Being Eliminated

Completed Standards

Stock-based compensation and other stock-based payments

- Canadian and US standards are now essentially the same. Differences reported in 2006 relate for the most part to transitional effects.
- Estimated # of transitional differences – **53**

Financial instruments, hedge accounting, and certain debt and equity securities

- Canadian standards have been harmonized with US and IASB standards on accounting for investments, derivatives and hedges effective for fiscal years beginning on or after October 1, 2006. Thus, differences reported in 2006 will be largely eliminated, except that some transitional effects may persist for some time and Canadian companies will be able to create certain voluntary differences with US GAAP in a few areas where Canadian standards allow alternatives not permitted under US GAAP.
- # of differences – **109**

Other transitional differences re: standards that were effective in prior years

- These differences will ultimately disappear as change effects are reflected in subsequent years' income. The more significant reported transitional differences in 2006 are in respect of Canadian standards in the following areas that were harmonized with US GAAP in prior years: business combinations, impairment of long-lived assets, pensions and post-employment benefits, and income taxes.
- # of differences – **29**

AcSB Projects Underway or Planned

Deferral of costs

- The AcSB is addressing the capitalization of internally developed intangibles, including R&D. This project is likely to largely eliminate the deferral of start-up costs (which gave rise to 20 differences in 2006). The AcSB project is expected to result in Canadian standards that are more consistent with IASB standards on internally developed intangibles. However, these IASB standards differ from US GAAP, and it is not yet clear to what extent, if any, the AcSB project will reduce differences with US GAAP in respect of R&D and other deferred costs.
- # of differences that can expected to be eliminated – **20**

Joint ventures

- The AcSB has a project to largely converge accounting for joint ventures with the standard to result from an IASB project. It is expected that the IASB will require equity accounting for joint ventures, which will eliminate the large majority of differences with US GAAP resulting from Canadian standards that require proportionate consolidation.
- # of differences relating to proportionate consolidation – **24**

Other

- These relate to business combinations and income taxes.
- # of differences – **13**

Total of above differences that can be expected to be eliminated — approximately 248

These constitute approximately 44 percent of the total differences reported by the 126 companies in the 2006 survey. It is emphasized, however, that transitional differences may take some time to work through, and some allowance of alternatives under Canadian standards and the possibility of different interpretations in light of circumstances in practice, may lead to some additional differences in these areas.