REPORTED CANADIAN/US GAAP DIFFERENCES

Summary of Survey of Canadian Annual Reports for Years Ending in 2004

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 2004. All the companies selected for this study have listings on major US stock exchanges or issue debt securities in the US.

In recent years, a major focus of the Canadian Accounting Standards Board (AcSB) has been the harmonization of Canadian accounting standards with those in the United States — that is, the elimination of significant unjustifiable differences between Canadian and US GAAP. The AcSB has recently adopted a new Strategic Plan that calls for the adoption of International Accounting Standards Board (IASB) standards for publicly accountable enterprises. This will result in some reorientation of AcSB standard-setting activities. The AcSB will work to eliminate remaining significant differences with US GAAP where their elimination is consistent with the IASB convergence objective. The AcSB intends to avoid creating new differences with US GAAP during the transition period whenever possible. However, some new differences with US GAAP may be unavoidable as a result of the AcSB's new strategy, but such differences should generally be temporary because the US Financial Accounting Standards Board (FASB) and IASB are working together toward convergence of their standards.

Consistent with IASB objectives, the AcSB seeks to avoid excessively detailed "rules-based" standards, instead requiring reporting entities and their auditors to 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 necessarily 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. Accordingly, 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:

- All of the largest 200 Canadian companies by asset size (as reported in the Financial Post "FP 500", June 2003) that are SEC registrants (68 companies) were examined.
- A sample of additional Canadian companies listed on the NYSE, NASDAQ or AMEX was selected (82 companies). Preference was given to companies that were included in the 2003 survey.

11 companies included in last year's sample did not qualify for inclusion this year. In selecting replacement companies, an attempt was made to maintain the industry classification balance in order to maintain comparability. The industry classifications assigned by the System for Electronic Document Analysis (SEDAR) have been used for the purposes of this study.

This is the seventh such survey. The survey basis and approach are consistent with the 2000-2003 studies. The number of companies selected in each industry classification has remained fairly consistent since 2000. While there are undoubtedly some errors and omissions, it is believed with reasonable confidence that the survey captures the nature and extent of the significant differences reported in the surveyed annual reports.

III – Companies Not Providing a Reconciliation of Canadian – US GAAP Differences

Nine companies in the survey prepared financial statements in US GAAP and did not provide a GAAP differences reconciliation. This is a decrease of three from the preceding year, and eight from 2002. An additional 12 companies provided only US GAAP financial statements in their 2004 annual reports but included reconciliations to Canadian GAAP. Of the 141 companies reporting Canadian/US GAAP differences (150 – 9 that did not provide reconciliations), 135 provided reconciliations in the notes to their audited financial statements. Six companies provided this information only in filings with the SEC.

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 regarding the differences and, when relevant, their effects on income. However, some others provided information that was highly summarized, so that it was sometimes impossible to separate differences and assess their effects on income. There were also some statements that included long and complex notes that obscured information.

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

V – Analysis of Reported Differences – General Comments

The 141 companies reporting Canadian/US GAAP differences reported a total of 639 differences. There are several reasons for the persistence of a significant number of reported differences:

<u>Transitional effects</u>

- Several standards issued during this period by the AcSB that harmonize Canadian GAAP with US GAAP were not yet effective.
- Some transitional differences persist in respect of harmonized standards that are in effect (and some could persist for many years).
- Some new standards are developed and put into effect in the US before harmonized standards are put in place in Canada, creating differences until the Canadian standards are effective.

<u>Economic circumstances</u>

- Some differences occur or are significant in some years and not in others depending on the types of transactions and events taking place, and economic conditions.

The following differences were particularly significant:

- The largest number of differences relate to accounting for financial instruments, investments and hedges. These are 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 (90 companies reported differences resulting from these standards in 2004); and
  - — SFAS 115, *Accounting for Certain Debt and Equity Securities*, which has been in effect since 1994 (46 companies reported differences from this standard).

  These differences will be largely eliminated when new Canadian standards recently issued by the AcSB come into effect.

- 66 companies reported differences in accounting for pensions and other employee benefits in 2004, increased from 28 in 2001. The increase is largely the result of poor investment performance and reduced interest rates, which caused the fair value of pension plan assets to fall and the present value of defined benefit plan obligations to rise. US GAAP require that companies record a liability and a charge to other comprehensive income when a measure of plan obligations exceeds the fair value of pension plan assets and unamortized past service costs. Canadian standards do not have this requirement.

- Differences relating to employee stock compensation have increased in recent years (60 differences reported in 2004). These are almost all due to accounting for employee stock-based compensation. Canadian and US standards are now essentially the same. 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.

The following is the range of reported differences per company between 2000 and 2004.

Number of companies:	**2004**	**2003**	**2002**	**2001**	**2000**
Reported no differences	6	6	6	6	3
Reported 1-3 differences	50	37	40	40	50
Reported 4-6 differences	55	53	57	53	48
Reported 7-9 differences	22	34	27	31	16
Reported 10 or more differences	8	8	3	3	1
Total number of companies	**141**	**138**	**133**	**133**	**118**

Prior to 2002, approximately two-thirds of the companies reported higher income under Canadian GAAP than under US GAAP. This has been declining since 2001 and in 2004 slightly more than half of the companies reported higher income under US GAAP than under Canadian GAAP.

Close to 70 percent of the individual differences are less than five percent of reported Canadian GAAP 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.

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, 11 companies reported that they chose not to follow US standards for interest capitalization in 2004. While some voluntary differences are reasonably evident, many differences are not described in sufficient detail for a financial statement reader to be confident in determining whether they are voluntary. For example, the voluntary vs. conflict nature of differences relating to cost deferrals is hard 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
- 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 2004 that may be expected to be eliminated in future years in respect of the more significant standard-setting projects completed or underway. These comprise almost half of the reported differences. It is to be noted, however, that some differences will persist for some time in each of these areas where there are transitional effects resulting from changes in standards. Reported differences with US GAAP that are not the subject of current harmonization projects include those relating to interest capitalization, R&D, minimum pension liabilities and asset allowances, life insurance accounting, extractive industry reserves, joint ventures, "fresh start" accounting for certain restructurings, revenue recognition, and some consolidation and equity accounting matters. The AcSB is looking to the IASB and international convergence projects in these areas, which are likely to improve upon US standards and may, in some cases, move closer to existing Canadian standards than 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]	**No project in process**	**Comments**
Foreign currency translation	30	20*		10		Mostly related to hedge accounting
Asset retirement obligations	8	8*				
Stock compensation	60	41*	19			
Impairment of long-lived assets	20	13	6		1	"No project" differences are re oil and gas properties, and are subject of a global project
Business combinations	13	7	4	1	1	"No project" difference re life insurance, which is subject of a global project
Pensions and other employee benefits	66	41	1		24	Mostly minimum pension liability. Also pension asset allowance. (Targeted for a global project)
Income taxes	26	21	2		3	Use of "substantially enacted" rates in Canada, which is subject of a global project
Financial instruments and hedging	90	45*	45			
Debt/equity classification	38	21*, ***	6	11		
Consolidation/ equity method	24	18**			6	These may be addressed in global projects

* These immaterial items will largely be eliminated as a result of active or imminent AcSB/FASB projects.

** These immaterial items were not analyzed to ascertain if they might be affected by active or imminent AcSB/FASB projects.

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

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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 AcSB and/or FASB but either they are not yet in effect in both countries or there 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 Projects activated or imminent by AcSB and/or FASB.

Topic	Total reported	Immaterial income effect	Transition	In process	No project in process	Comments
Joint ventures	37	34***			3	Canada unique in requiring proportionate consolidation (targeted for a global project). Also some income differences on contributions to joint ventures
Restructurings	8	4	1		3	“Fresh start” used in Canada
Leases	11	8***			3	Targeted for global project
Capitalized interest	11	9			2	Voluntary difference, subject of an IASB project
Deferred charges	48	30		10	8	Items in “No project” column include mining and life insurance, which are subjects of global projects
Investments — cost/fair value	46	24*	22			
PP&E and depreciation	10	7			3	“No project” differences relate to mining reserves, which are subject of a global project
R&D	22	17			5	Canadian GAAP arguably superior (targeted for global project)
Shareholders’ equity	25	24***			1	Income differences relate to flow-through shares, but most differences are reclassifications within equity
Revenue recognition	12	8			4	Global project underway
Other	34	28**		2	4	

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** These immaterial items were not analyzed to ascertain if they might be affected by active or imminent AcSB/FASB projects.

*** These items do not affect, or have an immaterial effect on, reported income but many of them may materially affect assets, liabilities, 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 2004 relate for the most part to transitional effects.
- # of differences – **60**

Impairment of long-lived assets

- Impairment provisions of Section 3061, *Property, Plant and Equipment*, replaced by Section 3063, *Impairment of Long-Lived Assets* have been harmonized with FASB standards, effective for fiscal years beginning on or after April 1, 2003.
- # of differences – **20** (18 differences are transitional effects. Two are in respect of oil and gas company assets.)

Asset Retirement Obligations

- New Section 3110, *Asset Retirement Obligations,* has been harmonized with FASB Statement No. 143, *Accounting for Asset Retirement Obligations*. Section 3110 is effective for fiscal years beginning on or after January 1, 2004.
- # or differences – **8**

Financial instruments and hedge accounting

- The AcSB has now issued a set of Canadian standards that, upon becoming effective, will harmonize Canadian GAAP with US and IASB standards on accounting for investments (SFAS 115, *Accounting for Certain Debt and Equity Securities*) and derivatives and hedges (SFAS 133, *Accounting for Derivatives and Hedging Activities*, and subsequent amendments).
- # of differences – **136** (Canadian companies will be able to create certain voluntary differences with US GAAP in a few areas where Canadian standards allow some alternatives not permitted under US GAAP.)

Consolidation of variable interest entities

- Canadian standards have now been harmonized with FASB standards, in requiring that entities that are financially dependent on a primary beneficiary be consolidated by the primary beneficiary. The Canadian standard is effective for all annual or interim periods beginning on or after November 1, 2004.
- # of differences **7**

Other transitional differences re standards that were effective in prior years

- These are the effects of differences in the treatment of changes arising on adopting new standards. These differences will ultimately disappear as change effects are reflected in subsequent years' income. Reported transitional differences in 2004 are in respect of standards in the CICA Handbook – Accounting in the following areas that were harmonized with US GAAP in prior years: business combinations, pensions and postemployment benefits, income taxes, securitizations, goodwill and other intangibles, and restructurings.

- # of differences **38**

AcSB Projects Underway or Planned

Debt-equity classifications

- The AcSB has amended one requirement in Section 3860, *Financial Instruments — Disclosure and Presentation*, concerning the classification of issued securities as liabilities or equity. This should result in eliminating 22 of the 38 reported differences when that amendment becomes effective (fiscal years beginning on or after November 1, 2004). Remaining differences are the subject of issues being addressed in the FASB project on liabilities and equity.
- # of differences – **38**

Accounting standards improvements

- The AcSB commenced a series of projects to amend and improve certain standards in the CICA Handbook – Accounting that are no longer relevant, are incomplete, or contain unjustified inconsistencies with US and International Accounting Standards Board GAAP, or where there may be questions of style, lack of specificity, or effectiveness. These projects include addressing current Canadian GAAP with respect to the deferral of costs (which resulted in 48 reported differences in 2004). These projects can be expected to result in some significant reduction of differences with US GAAP, but it is too early to estimate the number of differences that will be eliminated.

Total of above differences that can be expected to be eliminated — approximately 300

These constitute close to 50 percent of the total differences reported by the 141 companies in the 2004 survey. It is to be noted, however, that transitional differences may take some time to work through, and different interpretations in light of circumstances in practice may lead to some additional differences in these areas.