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CANADIAN v. U.S. REPORTING REQUIREMENTS

by

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PRONOUNCEMENTS/POLICIES

Accounting Standards Board (AcSB)

Canadian Emerging Issues Committee (EIC)

U.S. Securities and Exchange Commission (SEC)

Financial Report Releases (FRRs)

FASB EXPOSURE DRAFT

U.S. Financial Accounting Standards Board (FASB)

**“Invitation to Comment on Valuation Guidance
for Financial Reporting”, January 15, 2007**

(fasb.org)



FAIR VALUES AND FINANCIAL REPORTING UNDER GAAP

INTRODUCTION

- **Financial statements receiving unprecedented scrutiny by investors and OSC/AMF**
- **Auditing firms carefully scrutinizing work of outside experts**
- **Valuation experts must understand technical aspects and valuation issues from perspective of auditor**



INTANGIBLE ASSETS AND GOODWILL

- **Intangible assets, including IP, are increasing proportion of assets of many businesses**
- **Goodwill no longer amortized, but tested for impairment using two-step process**
- **Intangible assets with finite useful lives are amortized**
- **Intangible assets with indefinite useful lives are not amortized**



INTANGIBLE ASSETS

An intangible asset should be recognized apart from goodwill when:

a) asset results from contractual or other legal rights (regardless of whether they are transferable or separable from acquired enterprise or from other rights and obligations)

- OR -

b) asset is capable of being separated or divided from acquired enterprise and sold, transferred, licensed, rented or exchanged (regardless of whether there is an intent to do so).

Otherwise, asset should be included in goodwill.

SOURCE: CICA Handbook, Section 1581.48 and .49 and SFAS 141, Appendix A.



“FAIR VALUE”

“The amount of consideration that would be agreed upon in an arm’s length transaction between knowledgeable, willing parties who are under no compulsion to act”.

“The fair value at the date of acquisition is the fair value to the acquirer, recognizing all factors that may be relevant to that acquirer.”

SOURCE: Paragraphs 1581.06(b), 3062.05(a) and 1581.42 of CICA *Handbook*.



FAIR VALUE AND FINANCIAL REPORTING UNDER GAAP

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CURRENT VALUE/FAIR VALUE v. HISTORICAL COST

Debate continues as to relevancy of current value v. historical cost basis for financial reporting;

IASB wants current value (market-to-market value) adopted worldwide.



FAIR VALUE HIERARCHY

- Level 1

Quoted market prices in active markets, if available, are best evidence of fair value and therefore used as basis for fair value measurement, when available.



FAIR VALUE HIERARCHY

- Level 2

When quoted market prices are neither available nor representative of fair value, estimates of fair value are based on best information available, including prices for similar items and results of other valuation techniques.



FAIR VALUE HIERARCHY

- Level 3

A valuation technique based on multiples of earnings, revenue or a similar performance measure, if technique is consistent with objective of measuring fair value. ...



TESTING “LEVELS 2 AND 3” ESTIMATES

With DCF Method, there is greater uncertainty, being result of:

- (a)** length of forecast period;
- (b)** number of significant and complex assumptions associated with the process;
- (c)** higher degree of subjectivity associated with assumptions and factors used in process;
- (d)** higher degree of uncertainty associated with future occurrence or outcome of events underlying assumptions used; or
- (e)** lack of objective data when highly subjective factors are used.



PRONOUNCEMENTS FOR “FAIR VALUE” ACCOUNTING MEASUREMENTS AND DISCLOSURES UNDER GAAP

	<u>CANADA</u>	<u>U.S.A.</u>
Allocation of Purchase Price in Business Combinations	CICA 1581	SFAS 141
Annual Impairment Test — goodwill and other intangible assets	CICA 3062	SFAS 142
Reorganizations under bankruptcy laws: “fresh start” accounting (CCAA in Canada and Chapter 11 in the U.S.)	CICA 1625	SOP 90-7
Impairment or disposal of long-lived assets; Using Cash Flow Information and Present Value in Accounting Measurements	CICA 3063	SFAS 144, CON 7
Using the Work of a Specialist	CICA 5049	SAS No. 73, AU 336



VALUATION BASIS FOR INTANGIBLES

	GAAP	
	<u>CANADA</u>	<u>U.S.A.</u>
“Estimated or appraised values”	CICA 1581.43(e)	
“Estimated fair values”		SFAS 141.37(e)
“Fair value”		SFAS 142

Canada – CICA *Handbook*

U.S.A. – Statement of Financial Accounting Standards



FAIR VALUE MEASUREMENT CRITERIA

IASB set following criteria for Fair Value Measurement:

- 1. Quoted market prices in an active market**
- 2. Recent transactions for similar assets**
- 3. Other valuation techniques**



FRESH-START ACCOUNTING (CICA 1625 AND SOP 90-7)

- FVs of identifiable individual assets to be estimated.
- FVs of identifiable liabilities to be estimated.
- Guidelines for FV Measurement provided in CICA 1581 and SFAS 141.



FINANCIAL REPORTING FOR FIRMS EMERGING FROM CHAPTER 11 BANKRUPTCY

- In U.S., as part of revaluation, SOP 90-7 allows recognition of a reorganization goodwill — “reorganization value in excess of amounts allocable to identifiable assets” — which is amortized in conformity with the guidance in APB 17, *Intangible Assets*. Canadian GAAP does not (CICA 1625).
- Value of equity is recorded as difference between fresh start value of assets and liabilities.



ACCOUNTING STANDARDS BOARD (AcSB)

Implementation Plan for Interpreting IFRS into Canadian GAAP for publicly accountable enterprises (June, 2006)



INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

(iasb.org)

- **Convergence of GAAP**
- **Requires assets, liabilities and equity instruments to be measured at fair value**
- **Canadian subs: IFRS Standard 1, “First-time Adoption of International Financial Reporting Standards”**



IFRS

(CONT'D)

- **Board's objectives:**
 - a) **Establishing simple source of guidance for all fair value measurements required by IFRS**
 - b) **Clarify definition of fair value and relevant guidance**
 - c) **Enhance disclosures regarding fair value**



FINANCIAL REPORTING AND ACCOUNTING REPERCUSSIONS OF BECOMING REPORTING REGISTRANT IN THE U.S.

- **Canadian Accounting Standards Board has decided to adopt International Financial Reporting Standards (“IFRS”) by 2011**
- **No longer harmonizing Canadian GAAP with U.S. GAAP**
- **Although SEC has recognized IFRS as high-quality standards, it still requires reconciliation with U.S. GAAP**
- **Must comply with Sarbanes-Oxley**



FINANCIAL REPORTING AND ACCOUNTING REPERCUSSIONS OF BECOMING A REPORTING REGISTRANT IN THE U.S.

- **Requirement to file continuous disclosure with U.S. Securities and Exchange Commission (SEC)**
- **Reconciliation of Canadian GAAP and U.S. GAAP financial statements**
- **Some Canadian issuers even prepare separate set of U.S. GAAP financial statements to increase “credibility” of reporting in U.S.**
- **National Instrument 52-107 of Ontario Securities Commission now permits filing of U.S. GAAP financial statements for public companies that are SEC issuers (e.g., Alcan and Nortel filing U.S. GAAP financial statements for 2006)**



TORONTO VALUATION ACCORD

- **Signed in 2003**
- **Comprises North American valuation organizations**
- **Provides for participating organizations to coordinate efforts with regulatory bodies and standards-setting groups to aid in expediting simplification and convergence of financial reporting standards**



TORONTO VALUATION ACCORD

(CONT'D)

TVA coalition is united to promote use of market value in financial reporting in best interest of public, investors, government, and business decision makers.



TORONTO VALUATION ACCORD

(CONT'D)

At international level, TVA supports International Valuation Standards Committee (IVSC) in its work to ensure valuation standards consistent with and complementary to financial reporting standards developed and promulgated by IASB. TVA coalition intends to encourage *use of market value concepts* and aid in expediting simplification and convergence of financial reporting standards in North America and internationally.



INTERNATIONAL VALUATION STANDARDS COMMITTEE (IVSC)

- **43 Member States**
- **9 non-member representatives (observers)**
- **2 non-member representatives (correspondents)**
- **International Valuation Standards 2005**
- **Newsletters**
- **Technical Papers**
- **Research Papers**
- **Exposure Drafts**



IVSC (CONT'D)

OBJECTIVE

Develop and publish valuation standards and procedural guidance in valuation of assets for use in financial statements



- **Proposal for restructuring of IVSC issued in January 2007, inviting comments by March 9, 2007 (CommentLetters@ivsc.org)**
- **Goals**
 - **International Valuation Standards (IVS) and organizations promulgating them must be (1) relevant and (2) sustainable**



IVSC

(CONT'D)

- **Formulate and publish, in the public interest, valuation Standards for property valuation and to promote their worldwide acceptance; and**
- **Harmonize Standards among world's States and identify and make disclosure of differences in statements and/or applications of Standards as they occur.**



CANADIAN-U.S. GAAP DISCLOSURE DIFFERENCES

**Tax-related disclosures more exhaustive
in U.S. for both public and private
companies**



CANADIAN-U.S. GAAP REPORTING DIFFERENCES

- **Differential reporting available in Canada, not in U.S. (Canada exempts non-public enterprises from certain GAAP requirements applicable to public companies)**
- **Cumulative effects of accounting changes presented as adjustment to *retained earnings* in Canada; recognized in *net income* in U.S.**



CANADIAN-U.S. GAAP REPORTING DIFFERENCES

- **U.S. standards do not require comprehensive revaluation for reorganizations; Canadian standards do**
- **Deferred charges for pre-operating and other costs not permitted in U.S.**



CANADIAN-U.S. GAAP REPORTING DIFFERENCES

- **R&D costs expensed in U.S. but may be capitalized in Canada for technically and commercially feasible products and processes**
- **Proportionate consolidation in Canada (e.g., share of all assets and liabilities of joint venture on line-by-line basis) compared to equity method in U.S. (one line showing investment in joint venture)**
- **AcSB announced in September 2006 it was planning to remove proportionate consolidation**
- **U.S. has industry-specific guidance for recognizing up-front non-refundable revenue**



RECENT AREAS OF GAAP HARMONIZATION BETWEEN CANADIAN AND U.S. GAAP

- **Impairment of long-lived assets (2003)**
- **Asset retirement obligation (2004)**
- **Consolidation of variable interest entities (2005)**



BELL CANADA ENTERPRISES

Notes to Consolidated Financial Statements

Reconciliation of Net Earnings

	2005	2004	2003
Cdn GAAP – Earnings from continuing operations	1,915	1,447	1,820
Adjustments:			
○ Deferred costs	-	7	-1
○ Employee future benefit costs	-65	-75	-132
○ Equity income	46	52	50
○ Derivative instruments	-2	-	-12
○ Other	5	-	-8
U.S. GAAP – Earnings from continuing operations	1,899	1,431	1,717



BELL CANADA ENTERPRISES

Notes to Consolidated Financial Statements

Reconciliation of Total Shareholders' Equity

	2005	2004	2003
Canadian GAAP	14,721	14,024	13,565
Adjustments:			
○ Deferred costs	-37	-37	-44
○ Employee future benefit costs	-1,460	-283	-136
○ Goodwill	63	63	63
○ Other	21	33	47
○ Discontinued operations	-	-	-81
○ Unrealized gain on investments & derivative instruments	135	4	16
United States GAAP	13,443	13,804	13,430



BELL CANADA ENTERPRISES

Notes to Consolidated Financial Statements

Description of U.S. GAAP Adjustments (2005)

- **Deferred Costs**

Under Canadian GAAP, certain expenses, e.g., development and pre-operating costs, can be deferred and amortized if they meet certain criteria. Under U.S. GAAP, these costs are expensed as incurred



BELL CANADA ENTERPRISES

Notes to Consolidated Financial Statements

Description of U.S. GAAP Adjustments (2005)

● Goodwill

Under Canadian GAAP and U.S. GAAP, goodwill created on business acquisitions and purchase of non-controlling interests of subsidiaries is calculated in similar manner. Differences between Canadian GAAP and U.S. GAAP may cause underlying carrying value of net assets acquired or fair value of consideration given to differ. This causes resulting goodwill to differ.



BELL CANADA ENTERPRISES

Notes to Consolidated Financial Statements

Description of U.S. GAAP Adjustments (2005)

- **Accounting for Stock-Based Compensation**

Under Statement of Financial Accounting Standards (SFAS) No. 123, required to make pro forma disclosures of net earnings, and basic and diluted earnings per share, assuming that fair value-based method of accounting has been applied from date SFAS No. 123 was adopted.



BELL CANADA ENTERPRISES

Notes to Consolidated Financial Statements

Description of U.S. GAAP Adjustments

	2005	2004	2003
Net earnings reported	1,899	1,607	1,636
Compensation cost included in net earnings	22	29	29
Total compensation cost	-23	-38	-51
Pro forma net earnings	1,898	1,598	1,614



ALCAN INC.

Notes to Consolidated Financial Statements

Differences Between U.S. and Canadian GAAP (2005)

Significant differences between U.S. and Canadian GAAP. As mentioned in Note 2 – Change in Reporting Generally Accounted Accounting Principles, Company will cease to prepare reconciliation to Canadian GAAP subsequent to 2005, as permitted by CSA.



ALCAN INC.

Notes to Consolidated Financial Statements

Differences Between U.S. and Canadian GAAP (2005)

A. Derivatives

B. Currency Translation

C. Investments

D. Minimum Pension Liability

E. Asset Retirement Obligations



ALCAN INC.

Notes to Consolidated Financial Statements

Differences Between U.S. and Canadian GAAP (2005)

F. Deferred Translation Adjustments

G. Acquired In-Process R&D

H. Joint Ventures

I. Comprehensive Income

J. Income Taxes



NORTEL NETWORKS CORPORATION

Notes to Consolidated Financial Statements

Reconciliation from U.S. GAAP to Cdn. GAAP (2005)

- **New Canadian regulations allow issuers required to file reports with SEC, upon meeting certain conditions, to satisfy Canadian continuous disclosure obligations by using financial statements prepared in accordance with U.S. GAAP.**



NORTEL NETWORKS CORPORATION

Notes to Consolidated Financial Statements

Reconciliation from U.S. GAAP to Cdn. GAAP (2005)

“Subsequent to 2005, no further reconciliation or financial statement presentation in accordance with Canadian GAAP required under current Canadian regulations. Nortel will therefore not present Canadian GAAP financial statements or a reconciliation from U.S. GAAP to Canadian GAAP in 2006. Prior to 2004, Nortel prepared financial statements (with accompanying notes) and Management’s Discussion and Analysis – Canadian Supplement in accordance with Canadian GAAP and Canadian Securities Regulations, all presented in separate report and filed with relevant Canadian securities regulators in compliance with its Canadian continuous disclosure obligations.”



NORTEL NETWORKS CORPORATION

Notes to Consolidated Financial Statements

Differences Between U.S. and Canadian GAAP (2005)

Significant differences between U.S. GAAP and Canadian GAAP impacting consolidated financial statements of Nortel include:

- A. Business combinations**
- B. Derivative accounting**
- C. Financial instruments**
- D. Investments**



NORTEL NETWORKS CORPORATION

Notes to Consolidated Financial Statements

Differences Between U.S. and Canadian GAAP (2005)

(CONT'D)

- E. Other financial statement presentation differences**
- F. Joint ventures**
- G. Pension and other post-retirement benefits**



QUESTIONS?

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