



June 28, 2001

John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West  
Suite 800, Box 55  
Toronto, ON M5H 3S8

Dear Mr. Stevenson:

**Re: Financial Reporting in Canada's Capital Markets – Discussion Paper 52-401**

The Canadian Association of Petroleum Producers is pleased to offer our comments on the Canadian Securities Administrators' (CSA) discussion paper 52-401, Financial Reporting in Canada's Capital Markets. The attached submission discusses issues raised in the paper, especially the proposal to allow Canadian and foreign companies the option to file financial statements prepared using either of Canadian or US Generally Accepted Accounting Principles.

We look forward to hearing what other considerations may arise from representatives of other sectors of the Canadian economy, as well as what the CSA suggests as the next steps in this initiative.

Should you have any questions or comments on this submission please do not hesitate to contact me at (403) 267-1160 or by email at [daly@capp.ca](mailto:daly@capp.ca).

Sincerely,

David Daly  
Manager Fiscal Policy

***Attachment***

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2100, 350 – 7 <sup>th</sup> Ave. S.W. Calgary, Alberta Canada T2P 3N9 Tel (403) 267-1100 Fax (403) 261-4622	230, 1801 Hollis Street Halifax, Nova Scotia Canada B3J 3N4 Tel (902) 420-9084 Fax (902) 491-2980	905, 235 Water Street St. John's, Newfoundland Canada A1C 1B6 Tel (709) 724-4200 Fax (709) 724-4225
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Email: [communication@capp.ca](mailto:communication@capp.ca) Website: [www.capp.ca](http://www.capp.ca)



# Financial Reporting in Canada's Capital Markets

**Response by**

**Canadian Association of Petroleum Producers**

**to**

**Canadian Securities Administrators  
Discussion Paper 52-401**

**June, 2001**

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2100, 350 – 7<sup>th</sup> Ave. S.W.  
Calgary, Alberta  
Canada T2P 3N9  
Tel (403) 267-1100  
Fax (403) 261-4622

230, 1801 Hollis Street  
Halifax, Nova Scotia  
Canada B3J 3N4  
Tel (902) 420-9084  
Fax (902) 491-2980

905, 235 Water Street  
St. John's, Newfoundland  
Canada A1C 1B6  
Tel (709) 724-4200  
Fax (709) 724-4225

Email: [communication@capp.ca](mailto:communication@capp.ca) Website: [www.capp.ca](http://www.capp.ca)

## Introduction

The Canadian Association of Petroleum Producers (CAPP) represents 150 companies whose activities focus on exploration, development and production of natural gas, natural gas liquids, crude oil, synthetic crude oil, bitumen and elemental sulphur throughout Canada. CAPP member companies produce approximately 95 per cent of Canada's natural gas and crude oil. CAPP also has 120 associate members who provide the broad range of services that complete the infrastructure of this country's upstream crude oil and natural gas industry. Together, these members are an important part of a \$42-billion-a-year industry that affects the livelihoods of more than half a million Canadians. The association's mission statement is to enhance the economic well being and sustainability of the Canadian upstream petroleum industry in a socially, environmentally and technically responsible manner. For more information about the association please refer to our website at [www.capp.ca](http://www.capp.ca).

## Overview of CAPP response to Discussion Paper

CAPP thanks the Canadian Securities Administrators (CSA) for the opportunity to offer comments and responses to proposed changes to Canadian financial reporting requirements as discussed in your discussion paper 52-401, *Financial Reporting in Canada's Capital Markets*.

We agree that domestic and international capital markets continue to grow and change significantly. There is a growing global interdependence and convergence amongst the world's seekers of investment capital and their providers. The oil and gas industry is particularly aware of the need to access capital beyond our national borders. From 1990 through 2000 ARC Financial Corporation reports that the industry averaged \$13 billion per year in net capital investment in exploration and development activity to assure and expand Canada's supplies of petroleum and natural gas<sup>1</sup>. The same study forecasts capital expenditures to average \$26-27 billion per year for 2001-03. These investments are supported mainly by a combination of reinvested cash flow and new equity financing. Since 1996 oil and gas producers have raised \$1.0 – 4.5 billion per year in new equity. This level of financing necessitates attracting investment from outside Canada's capital markets, principally from the United States.

Similarly, shareholders in Canadian oil and gas companies are not restricted to only other Canadian petroleum producers when deciding where best to place their investment dollars.

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<sup>1</sup> ARC Financial Corporation, *Canadian Oil and Gas Industry Competitiveness and Financial Performance*, April 2001.

Investors compare their Canadian investment options against holding equity in oil and gas producers listed on foreign securities exchanges, whether the companies are active in Canada or not. Canadian shareholders who are deciding whether to hold equity in Canada or abroad, either through direct share ownership or indirect mutual fund unit purchases, rely on published financial reports to assess their investment choices. A good percentage of foreign equity owned by Canadians is in US companies.

In general, CAPP supports an option that would allow companies, both domestic and foreign, to file financial statements prepared using a set of generally accepted accounting principles (GAAP) that may differ from the current Canadian standard. This makes sense for both the offering of securities and for continuous disclosure purposes.

For the oil and gas industry and its shareholders, the equity markets of greatest significance outside Canada reside in the United States. As such, convergence or harmonization of Canadian and US accounting standards (compared to other international standards) would produce the greatest benefit to shareholders through information transparency and comparability across the border. Corporations benefit as well through the cost savings associated with the preparation of only one set of financial statements. Given the relative size of financial markets in the US and Canada, US GAAP is the best alternative for use as an optional standard in the preparation of a single set of financial statements.

CAPP's comments can be summarized as follows, after which are our responses to the discussion paper's specific questions:

- The option to file in both Canada and the US using only one set of accounting standards has significant positive streamlining and administrative cost benefits for the industry.
- Because of the growing convergence between Canadian and US equity markets, the accounting standards of choice for Canada as a filing option should be those endorsed by the US. At present this is US GAAP.
- IAS is not a concern for filers and investors in the Canadian oil and gas industry.
- Ideally, other regulatory filing requirements (e.g. for income tax filing purposes) should be modified to coincide with changes to GAAP standards for securities filing purposes. However, timing associated with the option to file under US GAAP standards should not be dependent on other regulatory changes. The US GAAP filing option should be available to companies as soon as possible.
- Under the suggested option approach smaller producers that do not file in the US would still have the option of continuing to file with Canadian GAAP rules.

## Questions Relating to Possible Changes to Current Requirements

*Q.1 Should we relax the current requirements for reporting issuers participating in Canada's capital markets to provide financial information prepared in accordance with Canadian generally accepted accounting principles? By reference to your own experience, please explain why Canadian GAAP as a consistent benchmark does or does not have continuing relevance to Canadian investors in the current environment.*

The sheer magnitude of the US equity market points naturally to US GAAP as being the eventual North American standard for financial reporting. The option to file financial statements prepared with US GAAP should be available for both Canadian and foreign issuers, as well as for continuous disclosure purposes. Comparability with statements prepared in other than US GAAP may be a concern for shareholders of some CAPP member companies. Two things address this concern:

- As Canadian GAAP continues to evolve the differences between Canadian and US GAAP will decrease over time. The Canadian Institute of Chartered Accountants (CICA) continues to develop GAAP standards in a way that brings them closer to those of the US. The 1999 report of the CICA task force on standards setting recommends that the Accounting Standards Board (AcSB) accelerate efforts to harmonize with US accounting standards. The recent CICA pronouncements have been in accordance with US GAAP (e.g. earnings per share calculations, income taxes, employee future benefits and stock based compensation).
- In many instances companies that would readily adopt US GAAP would more likely be compared to US companies, thereby improving comparability for shareholders.

*Q.2 Should any relaxation in current requirements address (a) foreign issuers; or (b) Canadian issuers; or (c) both foreign and Canadian issuers? Please explain the basis for your views, including addressing the basis for any distinction you believe should be made between the requirements for foreign issuers and those for Canadian issuers. If you believe a requirement for foreign issuers to reconcile their financial statements to Canadian GAAP should be retained, please comment on whether that requirement should apply to continuous disclosure as well as offering documents and information circulars.*

The standards and practices followed by the issuer should be more important than whether the issuer is Canadian or foreign. As such, the change in current requirements should apply to both US-based and Canadian issuers, and should be applicable to continuous disclosure, offering documents and information circulars. Foreign filers whose statements are prepared using neither Canadian nor US GAAP should continue to provide a reconciliation to Canadian GAAP, but also be given the option of reconciling to US GAAP. This will encourage the eventual adoption of a uniform set of North American standards. In this regard, the option to use US GAAP cannot be

considered a “relaxation” of current requirements, as US GAAP is generally considered to be more detailed and prescriptive than Canadian GAAP.

Reconciliation from one standard to another is an added layer of confusion for the average investor. “How can a company have two different income numbers?” might be a typical question. A reconciliation process does not likely enhance the quality or usefulness of the financial statement information. The quality of financial information stems from the due diligence followed in their preparation, regardless of whether they reflect Canadian or US GAAP. Usefulness, in our view, is primarily a function of consistency (comparability) from period to period, in keeping with the statement in CICA Handbook 1000.12:

*Investors and creditors of profit oriented enterprises are interested . . . in predicting the ability of the entity to earn income and generate cash flows in the future to meet its obligations and to generate a return on investment.*

The usefulness of financial statements would not be significantly altered if a reconciliation to Canadian or US GAAP were not required, assuming the financial statements are prepared using one of those two standards.

Filers whose statements are prepared in other than Canadian or US GAAP should continue to provide a reconciliation to either of those alternatives as Canadian users, generally, are less familiar with other foreign or IAS GAAP.

There are currently instances in which a US company with a history of US financial reporting is required to provide a reconciliation to Canadian GAAP for the purposes of a new issue in Canada, but may satisfy continuous disclosure requirements by continuing to issue future financial statements using US GAAP. This one-time-only reconciliation requirement does not add to better shareholder understanding of the company’s financial position or aid in its comparison to its primary group of competitors (largely US-based). This requirement should disappear and be replaced with the option to file using US GAAP for new issues and continuous disclosure, for both Canadian and foreign-based corporations.

*Q.3 In your view, how should the CSA implement any relaxation in the requirement for a reconciliation from foreign GAAP to Canadian GAAP? Please consider at least the following possibilities:*

- (i) elimination of all reconciliation requirements, regardless of the basis on which a foreign issuer prepares its financial statements;*
- (ii) elimination of the requirement for a full reconciliation and its replacement with a requirement to reconcile only specified financial statement items. If you believe such an approach is appropriate, please describe how you believe it could be implemented;*
- (iii) elimination of all quantitative reconciliation requirements, regardless of the basis on which a*

*foreign issuer prepares its financial statements, and introduction of a narrative discussion of qualitative differences between the basis of accounting used in preparing the financial statements and Canadian GAAP;*

*(iv) elimination of the reconciliation requirement for only those foreign issuers that prepare financial statements in accordance with specified bases of accounting, e.g., IAS and US GAAP. If you recommend this approach, please set out the criteria you believe should be applied in making this determination and indicate which bases you believe would meet these criteria;*

*(v) identification of specific reconciliation requirements depending on the type of transaction, type of security or proportionate interest of Canadian investors. If you believe such an approach is appropriate, please describe how you believe it could be implemented*

North America should be moving to a uniform set of accounting and reporting standards. To encourage that uniformity we believe US GAAP filers and Canadian filers should be allowed the option of filing statements using either Canadian or US GAAP without reconciliation.

For other than US or Canadian GAAP filers, there should be a reconciliation to Canadian or US GAAP.

*Q.4 If you believe Canadian companies should no longer be required to prepare financial statements in accordance with Canadian GAAP, what alternatives do you believe should be available and why are they an appropriate basis for a Canadian company to participate in Canadian capital markets? Please comment on the impact of the concessions you propose on the comparability of financial information available about Canadian companies in the Canadian capital markets. Is it important that Canadian investors have access to financial information prepared on a comparable basis? If not, why not?*

To encourage the migration to a set of North American accounting and reporting standards, Canadian securities regulators should allow companies the option of filing Canadian or US GAAP statements, without reconciliation.

A primary function of financial statements should be consistency (comparability) from period to period, in keeping with CICA Handbook 1000.12. On a secondary level allowing the filing of US GAAP statements will also enhance comparability between Canadian issuers' results and their US competitors. For the Canadian oil and gas industry, the majority of senior Canadian oil and gas producers are cross border filers reflecting the continental and international character of the industry. Consequently, for North American senior producers, comparability will be enhanced.

For junior and intermediate oil and gas producers that file only in Canada, they would still be able to prepare statements only in Canadian GAAP, if they so choose. This would allow comparability across companies within this segment.

*Q.5 On the basis of your own knowledge and experience, what is your assessment of the ability of Canadian issuers, auditors and users to prepare, audit and make use of financial statements prepared on bases other than Canadian GAAP?*

Issuer and auditor knowledge and experience with US GAAP is not a significant issue. Current domestic cross-border filers are familiar with Canadian-US GAAP reconciliation, while companies that do not access foreign capital will not need to be concerned with US GAAP.

We suspect that, except for analysts and sophisticated investors, many users have difficulty in reading and fully understanding financial statements. There may be a question of Canadian investors being able to fully understand and interpret a Canadian company's statements that are prepared solely according to US GAAP. Recent CICA initiatives at harmonization with US GAAP have left few significant remaining GAAP differences. As Canadian and US GAAP standards continue to evolve towards each other this becomes less and less of an issue.

*Q.6 If you believe alternatives to Canadian GAAP should be permitted, what specific steps should the CSA, the accounting profession or others take to facilitate implementation in a way that overcomes the issues identified in section 5 of the paper and ensures Canadians are provided with high quality, relevant, reliable and understandable financial information? Please comment on: (i) the steps you believe the CSA should take to ensure their ability to provide appropriate regulatory oversight over the financial statements provided to participants in Canada's capital markets; and (ii) changes to incorporating statutes that would be required to facilitate the financial reporting environment you envisage.*

Many of the issues referred to in this question – GAAP relationships, comparability, cost/benefit – focus on US GAAP and knowledge and experience with US GAAP have been addressed in previous questions. As previously noted, we do not see any significant impediments to allowing companies the option of filing statements under US GAAP.

The merits of an eventual single set of accounting and reporting standards should overshadow any concerns about Canadian sovereignty. Harmonization and convergence ultimately benefit all participants in the securities markets, investors and companies alike, on both sides of the border.

If Canadian issuers were allowed to report using Canadian or US standards, the Canada Business Corporations Act, the equivalent provincial acts, and the Income Tax Act should be reviewed for possible changes. All of these documents refer to financial statements being prepared according to Canadian GAAP. As well, there are probably many commercial contracts that would have to be changed if they reference Canadian GAAP. This latter item is, however, a company specific issue.



*Q.7 If you believe the accounting standards of certain foreign countries, e.g., US GAAP, should be acceptable for use by Canadian companies while other foreign GAAP should not, what is your basis for this distinction?*

The CICA survey of 1999 financial statements of 200 companies filed with Canadian securities commissions included only three companies with a reference to IAS GAAP, whereas 85 companies included a note (and reconciliation) on differences between Canadian and US GAAP<sup>2</sup>. This is a significant proportion of the companies surveyed and suggests that there is an acceptable level of understanding of US GAAP by Canadian cross border filers, as well as users of those statements. These same companies would likely be among the first to elect to file US GAAP statements in Canada given the option to do so, despite US GAAP's more detailed and prescriptive nature.

The small number of companies referencing IAS GAAP indicates a need for more education regarding IAS standards before those standards would be acceptable for Canadian filings without a reconciliation to Canadian or US GAAP.

*Q.8 If you believe US GAAP should be permitted as an alternative basis for preparation of a Canadian company's financial statements, should that alternative be available to all Canadian companies or to only a limited group such as those that are SEC registrants and are therefore required to provide either US GAAP financial statements or a reconciliation to US GAAP? Similarly, if you believe Canadian companies should be permitted to use other bases of accounting such as IAS or UK GAAP, should those alternatives be available to all or to a limited group only? If you believe the alternatives should be available to a limited group only, what criteria should be applied to determine eligibility?*

Both Canadian and foreign-based companies should be treated equally. As such, all Canadian companies should be allowed the option of filing statements under either of Canadian or US GAAP. Companies electing to prepare financial statements under another set of standards (e.g. IAS or UK standards) should be required to reconcile those statements to either Canadian or US GAAP.

*Q.9 Regardless of which bases of accounting you consider acceptable as alternatives to Canadian GAAP, should a Canadian company using one of those alternatives be required to present a reconciliation to Canadian GAAP in some or all cases? If so, in what form should the reconciliation be presented, e.g., a full quantified reconciliation or something less, such as a reconciliation of only specified financial statement items or a qualitative discussion of differences?*

A large part of the interest in using an alternate GAAP is to simplify financial reporting by using only one set of accounting standards. Any requirement to reconcile to Canadian GAAP would

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<sup>2</sup> CICA, *Financial Reporting in Canada – 2000*, pp. 34, 61-62.

negate most of the benefit of allowing use of an alternate GAAP. If an alternate like US GAAP is acceptable for use in Canada, it should be acceptable for all reporting requirements.

*Q.10 If the CSA permits alternatives to Canadian GAAP, what transitional issues would need to be addressed to facilitate implementation of the change? For example, in the first period in which a Canadian company presents financial statements prepared in accordance with a basis of accounting other than Canadian GAAP should comparative information for all prior years presented be required on a consistent basis?*

One of the primary objectives of financial statements should be comparability from period to period. Should the CSA allow the option of filing financial statements under US GAAP, then this change should be applied retroactively and financial statements of all prior periods should be restated to give effect to the new basis of financial accounting and reporting.

*Q.11-17 concern an assessment of IAS*

CAPP is not in a position to comment on IAS standards as most of our members are not involved in using accounting standards outside Canadian and US GAAP.

## Summary

While the specific accounting standards need to change to keep pace with business, the fundamental objective of financial reporting should not change.

The accounting profession has identified the objectives of financial reporting for business enterprises in *Statement of Financial Accounting Concepts No. 1 - Objectives of Financial Reporting by Business Enterprises* issued by the US Financial Accounting Standards Board and in section 1000 - Financial Statement Concepts of the CICA Handbook. Section 1000 (15) states:

*The objective of financial statements is to communicate information that is useful to investors, members, contributors, creditors and other users in making their resource allocation decisions and/or assessing management stewardship. Consequently, financial statements provide information about:*

- (a) an entity's economic resources, obligations and equity / net assets;*
- (b) changes in an entity's economic resources, obligations and equity / net assets; and*
- (c) the economic performance of the entity.*

As more and more companies access US capital markets and want comparability with their peers, an opinion we have heard is that following US GAAP, and only US GAAP, would be desirable.

CAPP's preference, however, would be for companies, whether Canadian or foreign-based, to have the option of using US GAAP as its primary accounting standard for both securities reporting and general regulatory purposes. It is possible that this election could lead to some companies following US GAAP and others the existing Canadian GAAP as articulated in the CICA Handbook.

GAAP differences between the US and Canada are continually being narrowed – a positive development which should, in time, eventually eliminate the differences. The uncertainty associated with the *mutual recognition approach* (in which Canada and the US would accept disclosure documents that comply with each other's accounting rules) associated with Multijurisdictional Disclosure System reporting makes time of the essence in moving towards a *uniform standards* or harmonization approach.

CAPP is concerned about investor and general public perception that companies with a choice of GAAP will select the accounting standard that presents their company in the most favourable light. This is an area of concern not just for oil and gas, but for all industries.

The benefits of allowing a choice of GAAP for financial reporting purposes is severely compromised if full reconciliations are still required for other statutory requirements, such as for tax preparation. We suggest that the CSA coordinate this initiative with other regulatory bodies in order to accomplish the maximum benefit.

The paper suggests that standards currently in development by the International Accounting Standards Committee (IASC) be considered as another alternative to Canadian GAAP, either on par or instead of US GAAP. By and large, IAS is not currently as developed or as broad as the standards developed by the FASB in the U.S. In a recent letter to Sir David Tweedie, Chairman of International Accounting Standards Board (IASB), PricewaterhouseCoopers commented:

*Harmonization of accounting standards around the world must be a key objective for the IASB. To promote the harmonization and convergence of accounting standards the Board must consider reducing the number of alternative accounting treatments permitted by IAS. The current model of benchmark and allowed alternatives provide for inconsistent application of IAS and will impede progress.*

While the IASC may not share these views of IAS shortcomings, CAPP believes that US standards, as detailed and prescriptive as they may be, are a better choice today for CSA filing considerations – an option made even more compelling by the US position as the dominant market for capital.

For countries and companies to operate on any scale in the global economy they will need to adopt and follow accounting standards that provide them with both access to the dominant capital markets and comparability with their peers. Today that market is found in the US. As such, US GAAP – accounting standards promulgated by the FASB and enforced by the SEC – should be the standard alternative to Canadian GAAP. Organizations that choose not to follow such standards can still grow and be successful, but on a much more country specific or domestic basis. The current trend suggests that over time all standards will tend to converge. The CSA can enable this harmonization by allowing the option to use US GAAP standards for both new issue and continuous disclosure reporting purposes.