

Compliance Expenditures

The total cost incurred by TransCanada to comply with the requirements of the SEC and Canadian securities regulatory authorities arising out of the *Sarbanes-Oxley Act of 2002* for the period January 1, 2002 to December 31, 2006, was estimated to be \$14 million, including third party charges of \$4 million.

SIGNIFICANT ACCOUNTING POLICIES AND CRITICAL ACCOUNTING ESTIMATES

Since determining the value of many assets, liabilities, revenues and expenses is dependent upon future events, the preparation of the Company's consolidated financial statements requires the use of estimates and assumptions which have been made using careful judgment.

Regulated Accounting

The Company accounts for the impacts of rate regulation in accordance with GAAP as outlined in Notes 1 and 11 to the consolidated financial statements. Three criteria must be met to use these accounting principles: the rates for regulated services or activities must be subject to approval by a regulator; the regulated rates must be designed to recover the cost of providing the services or products; and it must be reasonable to assume that rates set at levels to recover the cost can be charged to and will be collected from customers in view of the demand for services or products and the level of direct and indirect competition. The Company's management believes that all three of these criteria have been met. The most significant impact from the use of these accounting principles is that, in order to appropriately reflect the economic impact of the regulators' decisions regarding the Company's revenues and tolls, and to thereby achieve a proper matching of revenues and expenses, the timing of recognition of certain expenses and revenues in the regulated businesses may differ from that otherwise expected under GAAP as detailed in Note 11 to the consolidated financial statements.

Derivative Accounting

The Company enters into the following financial instruments to manage its risk exposure:

- power, natural gas and heat rate derivatives for overall management of its commodity price exposure;
- foreign currency and interest rate derivatives to manage its foreign exchange and interest rate risks related to its U.S. dollar denominated debt and transactions and interest rate exposures; and
- U.S. dollar denominated debt and U.S. dollar swaps, forwards and options to hedge the exposure on an after-tax basis of net investments in self sustaining foreign operations with a U.S. dollar functional currency.

Derivatives are recorded at their fair value at each balance sheet date. Derivatives and other instruments must be designated and be effective to qualify for hedge accounting. For cash flow and fair value hedges, gains or losses relating to derivatives are deferred and recognized in the same period and in the same financial statement category as the corresponding hedged transactions. Unrealized long-term gains and losses are included in Other Assets and Deferred Amounts, respectively. Unrealized current gains and losses are included in Other Current Assets and Accounts Payable, respectively. For hedges of net investments in self-sustaining foreign operations, exchange gains or losses on derivatives, after tax, and designated foreign currency denominated debt are offset against the exchange losses or gains arising on the translation of the financial statements of the foreign operations included in the foreign exchange adjustment account in Shareholders' Equity.

Assessment of effectiveness for those derivatives classified as hedges occurs at inception and on an ongoing basis. The determination of whether a derivative contract qualifies as a cash flow hedge includes an analysis of historical market price information to assess whether the derivatives are expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk. In the event that a derivative does not meet the designation or effectiveness criteria, realized and unrealized gains or losses are recognized in income each period in the same financial category as the underlying transaction giving rise to the exposure being economically hedged. If an anticipated transaction is hedged

and the transaction is no longer probable to occur, the related deferred gains or losses are recognized in income in the current period.

The recognition of gains and losses on derivatives for the Canadian Mainline, Alberta System, Foothills and the BC System exposures is determined through the regulatory process. Certain of the realized gains and losses on these derivatives are shared with shippers on predetermined terms. The gains and losses on derivatives accounted for as part of rate-regulated accounting that do not meet the criteria for hedge accounting are deferred.

The fair value for derivative contracts is determined based on the nature of the transactions and the market in which transactions are executed. Assumptions and judgements about counterparty performance and credit considerations are incorporated in the determination of fair value.

The Company estimates the fair value of derivative contracts by using readily available price quotes in similar markets and other market analyses. The number of transactions executed without quoted market prices is limited. The fair value of all derivative contracts is continually subject to change as the underlying commodity market changes and TransCanada's assumptions and judgments change. The fair value of foreign exchange and interest rate derivatives has been calculated using year end market rates. The fair value of power, natural gas and heat rate derivatives is calculated using estimated forward prices for the relevant period.

The chart below shows the effect that a one dollar change in the price of power (per MWh) or gas (per GJ) would have on the calculation of the fair values of derivatives as recorded on the balance sheet.

<i>(millions of dollars)</i>	Increase \$1	Decrease \$1
	Effect on fair value	Effect on fair value
Western Power Operations – power	– 8	+ 8
Eastern Power Operations – power	+ 2	– 3
Eastern Power Operations – gas	+ 19	– 19

Depreciation and Amortization Expense

TransCanada's plant, property and equipment are depreciated on a straight-line basis over their estimated useful lives. Pipeline and compression equipment are depreciated at annual rates from two to six per cent. Major power generation and natural gas storage plant, equipment and structures in the Energy business are depreciated at average annual rates ranging from two to ten per cent. Nuclear power generation assets under capital lease are amortized over the shorter of their useful life or the remaining terms of their lease. Other equipment is depreciated at various rates.

Depreciation expense for the year ended December 31, 2006 was \$1,059 million and primarily impacts the Pipelines and Energy segments of the Company. In Pipelines, depreciation rates are approved by the regulators, where applicable, and depreciation expense is recoverable based on the cost of providing the services or products. A change in the estimation of the useful lives of the plant, property and equipment in the Pipelines segment would, if recovery through rates is permitted by the regulators, have no material impact on TransCanada's net income but would directly impact funds generated from operations.