



February 9, 2006

**MANAGEMENT'S RESPONSIBILITY  
FOR FINANCIAL INFORMATION**

The accompanying consolidated financial statements, the notes thereto and other financial information contained in this annual report have been prepared by, and are the responsibility of, the management of The Westaim Corporation. Financial information contained throughout this annual report is consistent with the financial statements. These financial statements have been prepared in accordance with generally accepted accounting principles, using management's best estimates and judgements when appropriate. The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. Policies and procedures are designed to give reasonable assurance that transactions are properly authorized, assets are safeguarded and financial records properly maintained to provide reliable information for the preparation of financial statements. The Audit Committee, which is comprised of three Directors, none of whom is an officer of the Company, meets with management as well as the external auditors to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the consolidated financial statements and the report of the auditors. It reports its findings to the Board of Directors who approve the consolidated financial statements.

The consolidated financial statements have been audited by Deloitte & Touche LLP, the independent auditors, in accordance with generally accepted auditing standards. The auditors have full and unrestricted access to the Audit Committee.

**SIGNED**

**Barry M. Heck**  
President and  
Chief Executive Officer

**SIGNED**

**G.A. (Drew) Fitch**  
Senior Vice President and  
Chief Financial Officer

# Report of Independent Registered Chartered Accountants

To the Shareholders of  
The Westaim Corporation

We have audited the consolidated balance sheets of The Westaim Corporation as at December 31, 2005 and 2004, and the consolidated statements of operations and deficit and cash flow for each of the years in the three-year period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004, and the results of its operations and cash flow for each of the years in the three-year period ended December 31, 2005 in accordance with Canadian generally accepted accounting principles.

The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

*Deloitte & Touche LLP*

Independent Registered Chartered Accountants  
Calgary, Canada

February 7, 2006

## **Comments by Independent Registered Chartered Accountants for U. S. Readers on Canada - U.S. Reporting Differences**

The standards of the Public Company Accounting Oversight Board (United States) require the addition of an explanatory paragraph (following the opinion paragraph) when there are changes in accounting principles that have been implemented in the financial statements, such as the changes described in Notes 2(k), 2(l), 2(n) and 2(s) to the consolidated financial statements. Our report is expressed in accordance with Canadian reporting standards which do not require a reference to such changes in accounting principles in the report of Independent Registered Chartered Accountants when the changes are properly accounted for and adequately disclosed in the financial statements.

*Deloitte & Touche LLP*

Independent Registered Chartered Accountants  
Calgary, Canada

February 7, 2006

**THE WESTAIM CORPORATION**  
Consolidated Balance Sheets

(thousands of Canadian dollars)	December 31 2005	December 31 2004
<b>ASSETS</b>		
Current		
Cash and cash equivalents	\$ 115,673	\$ 89,139
Short-term investments	3,954	12,000
Accounts receivable	8,199	6,712
Inventories (note 5)	7,773	3,605
Other	570	538
	136,169	111,994
Other receivable (note 4)	-	1,800
Capital assets (note 6)	71,112	46,776
Capital assets available for sale (note 4)	-	5,500
Intangible assets (note 7)	5,180	5,693
Investments	-	500
	\$ 212,461	\$ 172,263
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current		
Accounts payable and accrued liabilities	\$ 16,302	\$ 12,963
Current portion of long-term debt (note 9)	10,312	-
	26,614	12,963
Long-term debt (note 9)	6,000	4,795
Provision for site restoration (note 10)	6,760	6,708
	39,374	24,466
Non-controlling interest (note 3)	15,447	-
Guarantees (note 14)		
Commitments and contingencies (note 15)		
Shareholders' equity		
Common shares (note 11)	421,466	421,233
Contributed surplus (note 11)	3,968	3,125
Cumulative translation adjustment (note 12)	(503)	-
Deficit	(267,291)	(276,561)
	157,640	147,797
	\$ 212,461	\$ 172,263

Approved on behalf of the Board:

**SIGNED**

Ian W. Delaney  
Director

**SIGNED**

Frank W. King  
Director

**THE WESTAIM CORPORATION**

## Consolidated Statements of Operations and Consolidated Statements of Deficit

	Year Ended December 31 2005	Year Ended December 31 2004	Year Ended December 31 2003
(thousands of Canadian dollars except per share data)		(Restated - note 4)	(Restated - note 4)
Revenue	\$ 28,560	\$ 31,907	\$ 17,123
Costs			
Manufacturing	10,799	8,450	5,835
Research and development (note 13)	36,514	35,489	25,871
General and administrative	4,109	5,240	3,817
Depreciation and amortization	7,338	5,722	5,001
Operating loss	(30,200)	(22,994)	(23,401)
Corporate costs	(8,217)	(7,396)	(9,550)
Foreign exchange	410	(563)	(2,081)
Interest	2,073	2,362	2,734
Gain on issuance of shares of subsidiary (note 3)	30,055	-	-
Writedown of capital assets and intangible assets	(570)	(22)	(723)
Gain on sale of investment	1,120	-	-
Loss from continuing operations before income taxes	(5,329)	(28,613)	(33,021)
Income tax expense (note 8)			
Current	(179)	(121)	(130)
Future	-	-	(4,698)
	(179)	(121)	(4,828)
Loss from continuing operations	(5,508)	(28,734)	(37,849)
Income from discontinued operations net of income taxes (note 4)	14,778	3,557	2,409
Net income (loss)	\$ 9,270	\$ (25,177)	\$ (35,440)
Income (loss) per common share (note 17)			
Continuing operations - basic and diluted	\$ (0.06)	\$ (0.34)	\$ (0.48)
Net Income (loss) - basic and diluted	0.10	(0.30)	(0.45)
Weighted average number of common shares outstanding			
Basic	92,852,120	84,093,827	78,044,689
Diluted	93,120,936	84,093,827	78,044,689
Deficit at beginning of year	\$ (276,561)	\$ (251,384)	\$ (215,944)
Net income (loss)	9,270	(25,177)	(35,440)
Deficit at end of year	\$ (267,291)	\$ (276,561)	\$ (251,384)

**THE WESTAIM CORPORATION**  
Consolidated Cash Flow Statements

	Year Ended December 31 2005	Year Ended December 31 2004	Year Ended December 31 2003
(thousands of Canadian dollars)		(Restated - note 4)	(Restated - note 4)
<b>Operating activities</b>			
Loss from continuing operations	\$ (5,508)	\$ (28,734)	\$ (37,849)
Items not affecting cash			
Depreciation and amortization	7,338	5,722	5,001
Foreign exchange on long-term debt	(1,637)	-	-
Provision for site restoration	-	327	-
Stock based compensation expense	905	1,210	942
Future income taxes	-	-	4,698
Writedown of capital assets and intangible assets	570	22	723
Deferred licensing revenue	-	-	(565)
Gain on sale of investment	(1,120)	-	-
Gain on issuance of shares of subsidiary (note 3)	(30,055)	-	-
Accounts receivable	(2,541)	(670)	365
Inventories	(4,341)	(831)	(544)
Other	(32)	121	136
Accounts payable and accrued liabilities	4,045	2,996	2,407
Site restoration expenditures net of recoveries	52	(1,183)	(185)
Cash used in continuing operations	(32,324)	(21,020)	(24,871)
Cash (used in) provided from discontinued operations	(518)	(2,221)	3,383
Cash used in operating activities	(32,842)	(23,241)	(21,488)
<b>Investing activities</b>			
Capital expenditures - continuing operations	(30,754)	(23,432)	(10,383)
Capital expenditures - discontinued operations	-	-	(1,745)
Intangible assets - continuing operations	(977)	(3,686)	(725)
Intangible assets - discontinued operations	-	-	(234)
Redemption and sale of short-term investments	98,335	149,151	53,332
Purchase of short-term investments	(90,289)	(137,708)	(51,525)
Proceeds on sale of investment	1,620	-	-
Proceeds on sale of assets	-	61	1,308
Proceeds on sale of discontinued operations (note 4)	22,614	30,559	-
Cash provided from (used in) investing activities	549	14,945	(9,972)
<b>Financing activities</b>			
Proceeds from long-term debt (note 9)	7,154	4,795	-
Issuance of common shares of subsidiary, net of share issuance costs (note 3)	45,502	-	-
Issuance of common shares (note 11)	171	47,946	102
Issuance of convertible debentures of subsidiary (note 9)	6,000	-	-
Cash provided from financing activities	58,827	52,741	102
Net increase (decrease) in cash and cash equivalents	26,534	44,445	(31,358)
Cash and cash equivalents at beginning of year	89,139	44,694	76,052
Cash and cash equivalents at end of year	\$ 115,673	\$ 89,139	\$ 44,694

**The Westaim Corporation**  
**Notes to Consolidated Financial Statements**  
**Years Ended December 31, 2005, 2004 and 2003**

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**1 BASIS OF PRESENTATION**

The Westaim Corporation (the "Company") was incorporated on May 7, 1996 by articles of incorporation under the Business Corporations Act (Alberta).

The consolidated financial statements include the accounts of the Company and its subsidiaries, iFire Technology Corp. ("iFire") and Nucryst Pharmaceuticals Corp. ("Nucryst").

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP" or "Canadian GAAP"). In addition, Note 19 describes and reconciles the significant measurement differences between Canadian and United States generally accepted accounting principles ("U.S. GAAP") affecting these consolidated financial statements.

All amounts are expressed in thousands of Canadian dollars except share and per share data unless otherwise noted.

**2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES**

**a) Principles of consolidation**

The financial statements of entities which are controlled by the Company through voting equity interests, referred to as subsidiaries, are consolidated. Entities which are jointly controlled, referred to as joint ventures, and entities which are not controlled but over which the Company has the ability to exercise significant influence, referred to as associated companies, are accounted for using proportionate consolidation and equity method, respectively. Investments in other entities are accounted for using the cost method. Variable interest entities ("VIEs") (which include, but are not limited to, special purpose entities, trusts, partnerships, certain joint ventures and other legal structures), as defined by the Canadian Institute of Chartered Accountants ("CICA") in Accounting Guideline 15 "Consolidation of Variable Interest Entities", are entities in which equity investors do not have the characteristics of a "controlling financial interest" or there is not sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. VIEs are consolidated by the Company when it is determined that it will, as the primary beneficiary, absorb the majority of the VIEs expected losses and/or expected residual returns. The Company currently does not have any VIEs. Intercompany accounts and transactions are eliminated upon consolidation and unrealized intercompany gains and losses are eliminated when accounting under the equity method.

**b) Use of estimates**

GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenue and expenses during the year. Significant estimates include the provision for site restoration, inventory valuation, fair value of stock-based compensation, valuation allowance against future income taxes, and useful lives of capital assets and intangible assets. Actual results could differ from those estimates.

**c) Translation of foreign currencies**

Transactions in foreign currencies are translated into Canadian dollars at rates of exchange at the time of such transactions. Monetary assets and liabilities are translated at current rates of exchange. Foreign operations are considered financially and operationally self-sustaining and are translated into Canadian dollars using the current rate method of translation. Under this method, assets and liabilities are translated at the year-end exchange rates. Unrealized gains and losses arising from translating

**2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (continued)**

net investments in foreign operations into Canadian dollars are included in shareholders' equity as a cumulative translation adjustment.

The Company changed its method of foreign exchange translation for Nucryst's United States based subsidiary (Note 3) from the temporal to the current rate method upon completion of Nucryst's initial public share offering in December 2005. Under the temporal method, all foreign exchange adjustments arising from the translation of the subsidiary's financial statements into Canadian dollars were included in the consolidated statement of operations. As required under GAAP, the change in accounting method was applied prospectively and resulted in a cumulative translation adjustment of \$503 being recorded as a separate component of shareholders' equity.

**d) Revenue recognition**

Specific revenue recognition policies for each of the Company's operating segments are as follows:

**Nucryst Pharmaceuticals** – Revenue from direct sales to third parties is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the price to the buyer is fixed or determinable, and collection is reasonably assured. The Company's revenues earned under license agreements consist primarily of manufacturing cost reimbursements, royalties and payments upon the achievement of specific milestones. For products manufactured under license, revenue is recorded at the date of shipment. Royalty revenue is earned based on a percentage of sales revenue earned by the licensee on its sales to third parties. Revenue relating to the achievement of milestones under licensing agreements is recognized when the milestone event has occurred. Nucryst also derives revenue from research activities and this revenue is recognized as services are performed.

**iFire Technology** – The Company recognizes revenue from licensing fees over the term that services are being rendered. Deferred licensing revenue represents amounts received under agreements for which the process of earning the revenue has not been completed. Royalties are recognized when earned in accordance with the terms of the specific agreement. As at December 31, 2005 and 2004, iFire was not party to any licensing fee or royalty agreements.

**e) Cash and cash equivalents**

Cash and cash equivalents consist of cash on deposit and highly liquid short-term investments with original maturities at the date of acquisition of 90 days or less and are recorded at cost.

**f) Short-term investments**

Short-term investments consist of money-market instruments with maturities of less than one year. As at December 31, 2005, the Company held short-term investments recorded at a cost of \$3,954 (2004 – \$12,000) which reflects current market values.

**g) Inventory valuation**

Finished product, raw materials, materials in process, and spare parts and operating materials are valued at the lower of average cost and net realizable value.

**2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (continued)**

**h) Research and development costs**

Research costs are expensed as incurred and significant project development costs are capitalized in accordance with GAAP once the Company has determined that commercialization criteria concerning the product or process have been met. Amortization of these costs over their estimated useful life commences with the successful commercial production or use of the product or process. On an ongoing basis, management reviews the unamortized balance to ensure that the deferred development costs continue to satisfy the criteria for deferral and amortization.

As at December 31, 2005 and 2004, no development costs have been capitalized.

**i) Government assistance**

Government assistance towards research and development expenditures related to capital assets used for research and development is credited against the cost of the related capital asset and all other assistance is credited against the related expenses as incurred.

**j) Capital assets**

Land, buildings, machinery and equipment are stated at cost. Depreciation is calculated using a straight-line method based on estimated useful lives of the particular assets which is 20 years for buildings and 3 to 10 years for machinery and equipment.

The Company evaluates the carrying value of capital assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable, and recognizes an impairment charge when it is probable that estimated future non-discounted cash flows of the underlying assets will be less than the carrying value of the assets. Measurement of an impairment loss related to capital assets that management intends to hold and use is based on the fair value of the assets, whereas assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

**k) Site restoration costs and asset retirement obligations**

The total estimated costs of site restoration relating to tangible, long-lived assets have been accrued. Site restoration costs have been estimated, taking into consideration the anticipated method and extent of the remediation consistent with regulatory requirements, industry practices, current technology and the possible uses of the site. The estimated amount of future restoration costs is reviewed regularly based on available information. Where the forecasted net restoration costs exceed existing provisions, an additional expense is recognized in the period.

Potential recoveries of costs resulting from indemnifications provided by previous owners of the Company's industrial sites have not been recognized in these consolidated financial statements as the amount of recovery cannot be reasonably determined. Any future recoveries will be recorded when received.

Effective January 1, 2004, the Company adopted Section 3110 "Asset Retirement Obligations" of the CICA Handbook which addresses the financial accounting and reporting obligations associated with the retirement of tangible, long-lived assets and their associated net retirement costs. Under this Section, an asset retirement obligation is recognized at its fair value in the period in which it is incurred. Asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and a related amortization expense is recognized in future periods. Implementation of Section 3110

**2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (continued)**

did not have an impact on the Company's results from operations or its financial position as the assets subject to these new rules have been sold or written down to nominal value.

**l) Derivative financial instruments**

Derivative financial instruments may be utilized by the Company in the management of interest rate and foreign currency exposures. The Company's policy is not to utilize derivative financial instruments for trading or speculative purposes.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The Company may enter into forward agreements in order to reduce the impact of fluctuating interest rates on its short-term investments and fluctuating foreign currency exchange rates on anticipated future cash flows. These forward agreements would not be designated as hedges for accounting purposes. They require the exchange of payments without the exchange of the notional principal amount on which payments are based. These instruments are recorded at the lower of cost or market. At December 31, 2005 and 2004, there were no open forward rate agreement contracts.

Effective January 1, 2004, the Company adopted new Accounting Guideline 13 "Hedging Relationships" for identifying, designating and documenting hedge relationships, and assessing their effectiveness. The guideline provides parameters on the conditions necessary for hedge accounting to be applied, but does not specify the methods to be used in its application. The guideline, however, does require that the Company adopt an accounting policy for assessing the effectiveness of its hedge relationships. Any ineffectiveness related to instruments recorded in the statement of financial position is to be recognized in income for the period. The new guideline has not had a significant impact on the Company's financial results.

**m) Income taxes**

Income taxes are accounted for using the liability method of income tax allocation. Under the liability method, income tax assets and liabilities are recorded to recognize future income tax inflows and outflows arising from the settlement or recovery of assets and liabilities at their carrying values.

Income tax assets are also recognized for the benefits from tax losses and deductions that cannot be identified with particular assets or liabilities, provided those benefits are more likely than not to be realized. Future income tax assets and liabilities are determined based on the tax laws and rates that are anticipated to apply in the period of realization.

**n) Stock-based compensation plans**

The Company and certain of its subsidiaries have stock-based compensation plans, which are described in Note 11. Compensation expense for awards that call for settlement in cash or other assets is measured on an ongoing basis as the amount by which the quoted market price exceeds the exercise price at each measurement date. Any obligations related to increases in the value of Deferred Share

**2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (continued)**

Units ("DSUs"), Restricted Share Units ("RSUs"), Employee Bonus Appreciation Units ("BAUs"), and Stock Appreciation Rights ("SARs") are accrued when the change in value occurs with an offset to the consolidated statement of operations.

Any consideration paid by option holders for the purchase of stock is credited to capital stock. If plan entitlements are repurchased from the holder, the consideration paid is charged to retained earnings.

Effective January 1, 2004, the Company adopted revisions to Section 3870 of the CICA Handbook with respect to the accounting and disclosure of stock-based compensation. The revised Section 3870 requires that the fair value of stock options be recorded in the financial statements. These new rules applied to options issued on or after January 1, 2002. The Company elected to apply the provisions retroactively with restatement of prior years.

**o) Earnings per share**

Basic earnings per common share is calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated on the basis of the average number of shares outstanding during the period plus the additional common shares that would have been outstanding if potentially dilutive common shares had been issued using the "treasury stock" method.

**p) Employee future benefits**

All employee future benefits are accounted for on an accrual basis. The Company maintains defined contribution pension plans for its employees. These plans were funded \$745 during the year ended December 31, 2005 (2004 – \$602; 2003 –\$784).

**q) Discontinued operations**

Long-lived assets to be disposed of by sale are classified as held for sale in the period in which a formal plan of disposal has been approved, the assets are available for immediate sale and are actively being marketed, and it is expected that the sale will occur within one year. Long-lived assets to be abandoned are classified as held and used until they are disposed of.

Long-lived assets classified as held for sale are carried at the lower of their carrying amount and fair value net of estimated disposition costs. Losses are recognized immediately where carrying value exceeds fair value and gains are recognized at the time of sale.

The results of discontinued operations are reported separately, including gains or losses related to the disposal of related long-lived assets held for sale or disposal. Future costs associated with an exit or disposal activity are recognized in the period in which the liability is incurred.

**r) Intangible assets**

The Company's definite life intangible assets consist of the prosecution and application costs of patents and trademarks and are amortized on a straight-line basis over their estimated useful lives to a maximum of 10 years. The cost of maintaining patents and trademarks are expensed as incurred. The Company evaluates the carrying value of definite life intangible assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Any impairment in the carrying value is charged to expense in the period that impairment has been determined.

**2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (continued)**

Indefinite life intangible assets are recorded at fair value. On a regular basis, the Company reviews the carrying value of these assets for impairment. As at December 31, 2005 and 2004, the Company had no indefinite life intangible assets.

**s) Recent adopted and pending accounting pronouncements**

i) The Company adopted the CICA guideline on the consolidation of variable interest entities ("VIEs") on January 1, 2005. VIEs include entities where the equity invested is considered insufficient to finance the entity's activities. Under this new guideline, the Company is required to consolidate VIEs if the investments in these entities and/or the relationships with them result in the Company being exposed to a majority of their expected losses, being able to benefit from a majority of their expected residual returns, or both, based on a formula determined by the standard-setters. The implementation of this guideline did not have a material impact on the Company's consolidated statement of operations or consolidated financial position.

ii) In 2005, the CICA approved amendments to new Section 3831 "Non-Monetary Transactions" which would converge this Section with U.S. GAAP and with equivalent requirements in International Financial Reporting Standards.

This Section requires that that all non-monetary transactions be measured at fair value, unless certain criteria are met. The amendments replace culmination of the earnings process as the test for applying fair value measurement with a test of commercial substance. Culmination of the earnings process has been difficult to apply in practice and has depended on an assessment of whether the assets exchanged were similar. Commercial substance, however, involves satisfying one of two objectively determined tests based on assessments of cash flows expected with and without the exchange of the non-monetary items. The new requirements apply to non-monetary transactions initiated in periods beginning on or after January 1, 2006. The Company does not expect adoption of this new Section to have a material impact on the Company's consolidated statement of operations or consolidated financial position.

iii) In January 2005, the CICA issued a new Section to the CICA Handbook, Section 1530 "Comprehensive Income". Certain gains and losses arising from changes in fair value will be temporarily recorded outside the income statement in comprehensive income. This Section will apply for annual financial statements for fiscal years beginning on or after October 1, 2006. The Company is in the process of evaluating the impact of this new Section.

iv) In January 2005, the CICA issued Section 3855 "Financial Instruments – Recognition and Measurement" and Section 3865 "Hedges". Under these Sections, all financial instruments including derivatives are to be included on a company's balance sheet and measured, either at their fair value or, in limited circumstances, when fair value may not be considered most relevant, at cost or amortized cost. These Sections specify when gains and losses, as a result of changes in fair value, are to be recognized in the income statement. These Sections will apply for annual financial statements for fiscal years beginning on or after October 1, 2006. The Company is in the process of evaluating the impact of these recently issued Sections.

v) In January 2005, the CICA issued a new Section to the CICA Handbook, Section 3251 "Equity". This Section establishes standards for the presentation of equity during a reporting period. This Section will apply for annual financial statements for fiscal years beginning on or after October 1, 2006. The Company is in the process of evaluating the impact of this Section on its consolidated statement of operations and consolidated financial position.

## **2 SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES (continued)**

vi) In October 2005, the CICA Emerging Issues Committee issued Abstract No. 157, "Implicit Variable Interests Under AcG-15" (EIC-157). This EIC clarifies that implicit variable interests are implied financial interests in an entity that change with changes in the fair value of the entity's net assets exclusive of variable interests. An implicit variable interest is similar to an explicit variable interest except that it involves absorbing and/or receiving variability indirectly from the entity. The identification of an implicit variable interest is a matter of judgment that depends on the relevant facts and circumstances. EIC-157 will be effective in the first quarter of 2006. The implementation of this EIC is not expected to have a material impact on the Company's consolidated statement of operations or consolidated financial position.

vii) In December 2005, the CICA Emerging Issues Committee issued Abstract No. 159, "Conditional Asset Retirement Obligations" (EIC-159). This EIC determined that a conditional asset retirement obligation should not be recognized until the fair value of the liability can be reasonably estimated. EIC-159 will be effective for interim and annual reporting periods ending after March 31, 2006. The Company does not expect the adoption of this EIC to have a material impact on the Company's consolidated statement of operations or consolidated financial position.

## **3 GAIN ON ISSUANCE OF SHARES OF SUBSIDIARY AND NON-CONTROLLING INTEREST**

On December 29, 2005, the Company's formerly wholly owned subsidiary, Nucryst, completed an initial public offering in which 4,500,000 common shares were issued at a price of US\$10.00 per share. Net proceeds after commissions and expenses amounted to US\$39,095 (\$45,502). US\$6,850 of the proceeds were used to reduce the term loan owing by Nucryst to the Company and the remaining balance of the term loan of US\$39,642 was converted to common shares of Nucryst on January 27, 2006. As a result of these transactions, the Company's ownership in Nucryst was reduced from 100% to 68.4% as at December 31, 2005 and increased to 75.3% after the conversion of the remaining term loan on January 27, 2006. The conversion of the term loan to common shares, completed in January 2006, was in accordance with the terms of the Nucryst initial public offering and has been accounted for as being effective on December 31, 2005 in accordance with GAAP. The reduction in the Company's equity interest in Nucryst has been accounted for as a disposition of shares and resulted in a dilution gain for accounting purposes of \$30,055 in 2005 and a non-controlling interest of \$15,447 as at December 31, 2005. The operating results relating to the non-controlling interest for the year ended December 31, 2005 were nil.

The Company will continue to consolidate the financial statements of Nucryst with the non-controlling interest being reported separately in the consolidated statement of operations and consolidated balance sheet.

## **4 DISCONTINUED OPERATIONS**

In December 2005, the Company completed the sale of land and building previously included in long-term capital assets available for sale. Prior to the sale, the land and building were leased to the future owner for the period April 1, 2005 to December 15, 2005. Net proceeds from the sale amounted to \$7,423 and the gain on sale of \$1,923 was included in income from discontinued operations in 2005.

In January 2005, the Company completed a series of transactions whereby two inactive wholly owned subsidiary companies participated in a Plan of Arrangement with two widely held publicly traded companies. This resulted in the reorganization of the participating companies into a single company and the dilution of the Company's investments to approximately 6.0%. The Company's pro rata interest in the book value of the recapitalized companies amounted to \$2,189. Subsequently, the company created under the Plan of Arrangement was listed on the Toronto Stock Exchange. The inactive subsidiaries were previously carried at nominal value and this transaction resulted in the Company recording a dilution gain

**The Westaim Corporation**  
**Notes to Consolidated Financial Statements**  
**Years Ended December 31, 2005, 2004 and 2003**

**4 DISCONTINUED OPERATIONS (continued)**

of \$2,189 in 2005. In February 2005, the Company sold its investment in the publicly traded company discussed above for net proceeds of \$11,519 and recorded a gain on sale of \$9,330. No income tax provision was recorded in relation to the dilution gain or the gain on sale of investment as these gains were more than offset by the reduction of unrecognized tax loss carry-forwards. As a result of the divestiture, the Company's non-capital losses, capital losses and research and development tax credits were reduced by approximately \$49,500, \$7,700 and \$600, respectively.

In January 2004, the Company sold substantially all of the assets and liabilities related to the Ambeon business segment, including its wholly owned subsidiary Neomet Limited, for proceeds of \$33,359 (net of transaction costs of \$911), of which, \$2,800 was held in escrow in respect of general representations and warranties relating to the sale transaction. At December 31, 2004, \$1,000 of this escrow receivable was reported in accounts receivable while \$1,800 was reported as a long-term other receivable. The entire escrow amount was received during 2005 and is included as proceeds on sale of discontinued operations in the consolidated cash flow statement. The net gain on the sale of Ambeon of \$5,436 was net of future income tax expense of \$1,032. The results of Ambeon's operations were accounted for on a discontinued basis. The Company determined that the net proceeds would exceed the net book value of the Ambeon business segment as at December 31, 2003 and therefore no adjustment to the carrying value of Ambeon was required. The gain on the sale of Ambeon was reported in 2004 and any costs incurred in subsequent periods related to discontinued operations have been reported in the period in which they occurred.

In 2005, the Company sold the remaining assets and operations related to Ambeon for net proceeds of \$873. The gain on sale of this business, amounting to \$739 has been included in discontinued operations and the results from operations of this business have been reclassified to discontinued operations resulting in the restatement of the December 31, 2004 and 2003 consolidated statements of operations and cash flow.

**Results of discontinued operations:**

	Year Ended December 31, 2005	Year Ended December 31, 2004	Year Ended December 31, 2003
<b>Revenues</b>			
Ambeon business segment	\$ 162	\$ 334	\$ 30,114
<b>Income (expense)</b>			
Dilution gain	\$ 2,189	\$ -	\$ -
Gain on sale of inactive subsidiaries	9,330	-	-
Gain on sale of capital assets available for sale	1,923	-	-
Gain on sale of Ambeon	739	5,436	-
Income (costs) related to discontinued operations	597	(1,879)	2,409
Net income from discontinued operations	\$ 14,778	\$ 3,557	\$ 2,409

The net income from discontinued operations is after deduction of depreciation and amortization of \$Nil for the year ended December 31, 2005 (2004 – \$ Nil; 2003 – \$1,738). Current income tax expense included in net income from discontinued operations for the year ended December 31, 2005 amounted to \$Nil (2004 – \$ Nil; 2003 – \$27).

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**4 DISCONTINUED OPERATIONS (continued)**

Net income per common share from discontinued operations was \$0.16 for the year ended December 31, 2005 (2004 – \$0.04; 2003 – \$0.03).

Amounts included in the consolidated balance sheets relating to discontinued operations are as follows:

	December 31, 2005	December 31, 2004
Accounts receivable	\$ –	\$ 54
Inventories	–	173
Accounts payable and accrued liabilities	(11)	(1,219)
Capital assets available for sale	–	5,500

**5 INVENTORIES**

	December 31, 2005	December 31, 2004
Raw materials	\$ 4,571	\$ 2,378
Materials in process	2,473	923
Finished product	614	154
Spare parts and operating materials	115	150
	\$ 7,773	\$ 3,605

**6 CAPITAL ASSETS**

December 31, 2005	Cost	Accumulated Depreciation	Net Book Value
Land	\$ 505	\$ –	\$ 505
Buildings	25,790	10,060	15,730
Machinery and equipment	69,802	19,633	50,169
Construction in progress	3,811	–	3,811
Computer hardware and software	4,345	3,448	897
	\$ 104,253	\$ 33,141	\$ 71,112

  

December 31, 2004	Cost	Accumulated Depreciation	Net Book Value
Land	\$ 505	\$ –	\$ 505
Buildings	15,022	8,913	6,109
Machinery and equipment	33,724	15,954	17,770
Construction in progress	22,093	–	22,093
Computer hardware and software	3,620	3,321	299
	\$ 74,964	\$ 28,188	\$ 46,776

The construction of iFire's pilot manufacturing plant for flat panel displays at its Toronto location was completed in December 2005 at which time depreciation of the plant commenced. Nucrust continues to expand its wound care production facility in Fort Saskatchewan, Alberta. As a result, at December 31,

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**6 CAPITAL ASSETS (continued)**

2005, capital assets include construction in progress in the amount of \$3,811 (2004 – \$22,093) that is not currently subject to depreciation. Depreciation on capital assets for the year ended December 31, 2005 was \$5,855 (2004 – \$5,260; 2003 – \$4,638).

**7 INTANGIBLE ASSETS**

	December 31, 2005	December 31, 2004
Patents and trademarks	\$ 8,601	\$ 7,591
Less accumulated amortization	(3,421)	(1,898)
	<u>\$ 5,180</u>	<u>\$ 5,693</u>

Amortization of intangible assets was \$1,483 for the year ended December 31, 2005 (2004 – \$462; 2003 – \$363).

**8 INCOME TAXES**

The following is a reconciliation of income taxes, calculated at the statutory income tax rate, to the income tax provision included in the consolidated statements of operations.

	Year Ended Dec. 31, 2005	Year Ended Dec. 31, 2004	Year Ended Dec. 31, 2003
Loss from continuing operations before income taxes	\$ (5,329)	\$ (28,613)	\$ (33,021)
Statutory income tax rate	33.62%	33.87%	36.74%
Expected income tax recovery	(1,792)	(9,691)	(12,132)
Losses and temporary differences			
– valuation allowance	12,023	9,691	16,830
Tax effect of items not subject to tax			
– gain on issuance of shares of subsidiary (Note 4)	(10,107)	–	–
Large corporations and capital taxes	55	121	130
Income tax expense	<u>\$ 179</u>	<u>\$ 121</u>	<u>\$ 4,828</u>
Classified as:			
Current	\$ 179	\$ 121	\$ 130
Future	–	–	4,698
Income tax expense	<u>\$ 179</u>	<u>\$ 121</u>	<u>\$ 4,828</u>

Income taxes are recognized for future income tax consequences attributed to estimated differences between the financial statement carrying values of existing assets and liabilities and their respective income tax bases.

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**8 INCOME TAXES (continued)**

The net future income tax asset is comprised of:

	December 31, 2005	December 31, 2004
Future income tax assets:		
Tax benefit of loss carry-forwards and tax credits	\$ 118,845	\$ 107,585
Provisions and reserves	3,359	3,174
Capital, intangible and other assets	1,935	5,223
Less valuation allowance	(108,122)	(110,537)
	16,017	5,445
Future income tax liabilities:		
Capital, intangible and other assets	(15,835)	(5,263)
Other	(182)	(182)
	(16,017)	(5,445)
Future income tax assets, net	\$ -	\$ -

The future income tax asset valuation allowance is in respect of tax loss carry-forwards and tax credits primarily relating to subsidiaries involved in technology development.

The Company has non-capital losses for income tax purposes of approximately \$237,341 (2004 – \$215,303; 2003 – \$192,764) that can be used to offset taxable income, if any, in future periods. These recognized losses have been fully offset by a valuation allowance and expire at various times to the end of 2025, with \$22,517 expiring by 2012. The Company also has capital losses of approximately \$20,224 (2004 – \$27,939; 2003 – \$5,865) as well as research and development tax credits of approximately \$47,380 (2004 – \$38,837; 2003 – \$29,419) which will expire at various times to the end of 2015. Cash taxes relating to continuing operations paid during the year amounted to \$270 (2004 – \$141; 2003 – \$155).

**9 LONG-TERM DEBT**

In January 2004, iFire entered into a Japanese Yen 1,080,000,000 loan agreement with Dai Nippon Printing Co., Ltd. ("DNP") to finance certain new equipment in iFire's Toronto pilot facility. The loan was drawn down during 2004 and 2005, carries an average interest rate of 1.64% per annum and is repayable in full in Japanese Yen on June 30, 2006. The loan is secured by the assets financed under the agreement. Interest expense on the loan amounted to \$137 for the year ended December 31, 2005 (2004 – \$13) and the liability reported at December 31, 2005 includes accrued interest of \$137 which is payable at the end of the loan term. As at December 31, 2005, the outstanding loan balance amounted to Yen 1,029,259,143 (\$10,175) (2004 – Yen 408,166,000 (\$4,782)). In 2005, the Company entered into forward transactions to purchase Japanese Yen 918,901,467 to hedge the foreign currency exposure of the loan. Unrealized losses on these hedges amounting to \$1,994 (2004 – \$Nil) have been included in foreign exchange in the consolidated statement of operations and accrued in accounts payable and accrued liabilities at December 31, 2005.

In February 2005, a wholly owned subsidiary of the Company issued \$6,000 of convertible debentures to private investors. These debentures mature in February 2007, bear interest at 5% per annum, have no recourse to the Company and are convertible into a maximum of 12,000,000 non-voting common shares of the inactive subsidiary. If converted, the Company's economic interest in the inactive subsidiary would be reduced to approximately 22% and the Company's consolidated non-capital losses and research and development tax credits would be reduced by approximately \$91,000 and \$18,000, respectively. These convertible debentures are financial instruments which have both debt and equity components. The value

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**9 LONG-TERM DEBT (continued)**

assignable to the conversion option at the date of issue was determined to be immaterial. Interest expense on these debentures during 2005 amounted to \$206 and was accrued in accounts payable and accrued liabilities at December 31, 2005.

**10 PROVISION FOR SITE RESTORATION**

Changes in the provision are as follows:

	Year Ended	
	December 31, 2005	December 31, 2004
Provision at beginning of year	\$ 6,708	\$ 7,564
Additional provisions	–	327
Expenditures incurred	(100)	(1,640)
Costs recovered	152	457
Provision at end of year	\$ 6,760	\$ 6,708

The provision relates primarily to site restoration associated with soil and groundwater reclamation and remediation, based on periodic independent estimates of these costs as at December 31, 2005.

Potential recoveries of costs resulting from indemnifications provided by previous owners of the Company's industrial sites have not been recognized in the consolidated financial statements as the amount of recovery cannot be reasonably determined. Any future recoveries will be recorded when received.

**11 CAPITAL STOCK**

**a) Share Capital**

The Company's authorized share capital consists of an unlimited number of common shares, Preferred A shares and Preferred B shares. Changes in the Company's common shares outstanding during 2005, 2004 and 2003 are as follows:

	2005		2004		2003	
	Number	Stated Capital	Number	Stated Capital	Number	Stated Capital
Balance at beginning of year	92,828,054	\$421,233	78,073,386	\$373,230	78,032,787	\$373,128
Employee share purchase plan	72,595	233	28,785	135	40,599	102
Share offering	–	–	14,705,883	47,801	–	–
Stock options exercised	–	–	20,000	67	–	–
Balance at end of year	92,900,649	\$421,466	92,828,054	\$421,233	78,073,386	\$373,230

During 2005, 72,595 (2004 – 28,785; 2003 – 40,599) common shares were issued with respect to the Company's employee share purchase plan at a weighted average price of \$2.36 (2004 – \$3.24; 2003 – \$2.50). The value of these rights to acquire common shares of \$62 (2004 – \$42; 2003 – \$Nil) was reclassified from contributed surplus to share capital.

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**11 CAPITAL STOCK (continued)**

No options of the Company were exercised in 2005 or 2003. In 2004, 20,000 options were exercised at an average price of \$2.59, and \$15 relating to the fair value of these options was reclassified from contributed surplus to share capital.

On August 4, 2004, the Company completed a \$50,000 share offering. A total of 14,705,883 new common shares were issued at a price of \$3.40. Four members of the Company's Board of Directors purchased 4,852,942 shares under the offering. Net proceeds, after fees and expenses, amounted to \$47,801.

**b) Stock-based compensation plans**

**Employee and Director stock option plan** – The Company maintains an Employee and Director Stock Option Plan under which the Company may grant options for 10,750,000 shares of common stock of the Company at an exercise price equal to the market price of the Company's stock at the date of grant. Options awarded are exercisable for a period of 10 years and vest as to one third of the grant on each of the first, second and third anniversaries after the date of the grant. The Company maintains a Directors and Officers Share Purchase Program under the provisions of the Stock Option Plan. Under the Share Purchase Program, Directors and designated officers may be granted one option for each common share purchased to a cumulative 50,000 options. Options, equal to the net purchases of common shares by the optionee during the calendar year, vest at the end of the calendar year in which the purchases were made. Any options issued under this program which do not vest at the end of the year are cancelled.

A summary of the status of the Company's stock option plans as at December 31, 2005, 2004 and 2003, and changes during the years ending on those dates is presented below:

Stock Options	2005		2004		2003	
	Number	Weighted Average Exercise Price	Number	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
Outstanding at beginning of year	4,659,600	\$ 6.94	5,833,400	\$ 8.71	5,665,599	\$ 9.41
Granted	390,000	\$ 3.66	497,500	\$ 3.61	427,800	\$ 1.87
Exercised	–	\$ –	(20,000)	\$ 2.59	–	\$ –
Cancelled	–	\$ –	(1,651,300)	\$ 12.25	(259,999)	\$ 12.62
Outstanding at end of year	5,049,600	\$ 6.68	4,659,600	\$ 6.94	5,833,400	\$ 8.71

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**11 CAPITAL STOCK (continued)**

The following table summarizes information about stock options outstanding as at December 31, 2005:

Range of Exercise Prices	Number Outstanding Dec.31, 2005	Options Outstanding		Options Exercisable	
		Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number Exercisable Dec.31, 2005	Weighted Average Exercise Price
\$1 – \$3	451,500	7.1	\$ 1.85	326,500	\$ 1.87
\$3 – \$6	2,240,700	4.4	\$ 4.17	1,640,700	\$ 4.35
\$6 – \$9	1,311,403	3.1	\$ 7.17	1,311,403	\$ 7.17
\$9 – \$12	431,000	4.4	\$ 10.45	431,000	\$ 10.45
\$12 – \$16	614,997	4.4	\$ 15.72	614,997	\$ 15.72
\$1 – \$16	5,049,600	4.3	\$ 6.68	4,324,600	\$ 7.24

Effective January 1, 2004, the Company adopted revisions to Section 3870 of the CICA Handbook with respect to the accounting and disclosure of stock-based compensation requiring that the fair value of stock options be recorded in the financial statements. For the year ended December 31, 2005, corporate costs, research and development costs, and selling, general and administrative expenses include additional compensation expense relating to stock options totaling \$905 (2004 – \$1,210; 2003 – \$942) with an offsetting increase to contributed surplus.

The fair value of each option grant by the Company and its subsidiaries is estimated using the Black-Scholes option pricing model assuming no dividends are paid on common shares, a risk-free interest rate of 4.33% (2004 – 4.80%; 2003 – 5.05%), an average life of 7.0 years and a volatility of 57.72% (2004 – 58.47%; 2003 – 59.89%). The amounts computed according to the Black-Scholes pricing model may not be indicative of the actual values realized upon the exercise of these options by the holders.

**Deferred share unit plan** – The Company maintains DSUs for the non-executive Directors of the Company. DSUs are issued at the market value of the Company's shares at the date of grant, vest upon death or retirement of the Director and are payable in cash. Directors may elect to receive additional DSUs in lieu of fees, which are issued at 90% of the market value of the Company's shares at the date of grant. Compensation expense relating to DSUs during the year amounted to \$888 (2004 – \$172; 2003 – \$572) and as at December 31, 2005, a liability of \$1,842 (2004 – \$954) has been accrued with respect to issued DSUs.

**Restricted share unit plan** – In 2004, the Company instituted a Restricted Share Unit Plan for the Executive Officers of the Company. These units vest over three years and are payable when fully vested in a combination of common shares and cash at the weighted average trading price at the date of exercise. The liability with respect to these units is accrued over the vesting period. Compensation expense with respect to RSUs during the year amounted to \$524 (2004 – \$139) and the corresponding accrued liability as at December 31, 2005 was \$663 (2004 – \$139).

**Employee share purchase plan** – Under the Employee Share Purchase Plan, employees are entitled to subscribe for common shares of the Company, to a maximum value of five percent of their annual compensation. Payment for these shares is made over a 24-month period at a price per share equal to the lesser of the market value at the offering date and the market value at the end of the purchase period. The market value at the offering date of July 18, 2005 was \$4.02 (July 19, 2004 – \$3.55; July 21, 2003 – \$2.36). At December 31, 2005 there were outstanding purchase arrangements with employees having an aggregate

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**11 CAPITAL STOCK (continued)**

value of \$474 (2004 – \$363; 2003 – \$389). During the year ended December 31, 2005, a total of 72,595 shares were issued under this Plan at an average price of \$2.36 (2004 – 28,785 shares at \$3.24; 2003 – 40,599 shares at \$2.50).

**Employee bonus appreciation units** – Employees of the Company, other than non-executive officers, are granted Bonus Appreciation Units ("BAUs"). BAUs are issued at the market value of the Company's shares at date of grant, vest over three years and are payable when vested in cash at the amount by which the market value of the Company's shares exceed the share price at the date of grant. Net changes in the value of BAUs is recognized as compensation expense over the vesting period. As at December 31, 2005, the accrued liability relating to BAUs amounted to \$178 (2004 – \$65).

**Subsidiary stock-based compensation plans** – The Company also maintains equity incentive plans for certain employees of its technology subsidiaries, Nucryst and iFire, under which stock options have been granted representing 5.0% to 5.5% of the outstanding shares of the respective subsidiaries. Effective January 1, 2004, these plans are being accounted for under the fair value method with the related compensation expense being recorded in the consolidated statement of operations. Subsidiary stock options generally vest evenly over a three-year period and expire after 10 years from the date of grant. The exercise prices of stock options granted are not less than the fair value of the subsidiary's stock at the time of the grant. No shares were issued by the Company in 2005, 2004 or 2003 with respect to these plans.

SARs have been granted to employees of certain technology subsidiaries. SARs vest over time and may be settled with cash, shares of the subsidiary and, in the case of iFire SARs, shares of the Company at the Company's option. The exercise prices of SARs granted are not less than the fair value of the subsidiary's stock at the time of the grant. The total potential liability upon exercise of these SARs is capped at \$1,462.

Net changes in the value of SARs, measured as the amount by which quoted market prices or fair value exceeds the exercise price at the measurement date, is recognized as compensation expense over the SARs' vesting period. As at December 31, 2005, the accrued liability relating to SARs amounted to \$105. The liability as at December 31, 2004 and 2003 was \$Nil as the estimated market value of the subsidiaries' SARs was less than their exercise price.

**12 CUMULATIVE TRANSLATION ADJUSTMENT**

The cumulative translation adjustment represents the net unrealized foreign currency translation loss on the Company's net investment in self-sustaining foreign operations.

	2005	2004
Cumulative translation adjustment beginning of year	\$ –	\$ –
Unrealized loss resulting from change in accounting policy (Note 2c)	(503)	–
Cumulative translation adjustment end of year	\$ (503)	\$ –
U.S. Dollar exchange rate, end of year	\$1.1659	\$ 1.2036

The change in cumulative translation adjustment is primarily the change in the rate of exchange between the Canadian dollar and the U.S. dollar and the effect this change has on the assets and liabilities of the Company's self-sustaining foreign subsidiary.

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**13 RESEARCH AND DEVELOPMENT FUNDING AGREEMENTS**

In 2001, iFire entered into a research and development contribution agreement with the Government of Canada through Technology Partnerships Canada ("TPC"). Under this agreement, TPC agreed to contribute 28.371% of eligible research and development costs and related capital expenditures incurred by iFire to a maximum of \$30,000.

Under the terms of the agreement, iFire will pay a royalty to TPC equal to 1.065% of eventual commercial sales of the technology under development. In addition, TPC received warrants to purchase common shares of iFire exercisable for an additional consideration of \$6,283. The warrants expire on December 31, 2009 and, as at December 31, 2005, represented approximately 0.5% of the current outstanding common shares of iFire.

Contributions were recorded as a reduction of the cost of the applicable capital asset or credited to the statement of operations of iFire as determined by the nature of the expenditure being funded. Contribution claims totaling \$5,997 were recorded in 2003. Of this amount, \$5,204 was credited to research and development expense and \$793 was credited to capital assets. As at December 31, 2003, the Company had received the maximum \$30,000 eligible funding.

On January 1, 2003, the Company entered into a series of agreements with a third party whereby the third party agreed to reimburse iFire for a portion of the costs related to research and development projects of mutual interest to iFire and the third party. These agreements provide for reimbursement totaling USD \$3,800 to be paid quarterly between January 2003 and October 2006. These reimbursements are recorded as a reduction to research and development expenditures in the consolidated financial statements and amounted to \$1,152 (2004 – \$1,251; 2003 – \$1,364).

**14 GUARANTEES**

The Company has agreements to indemnify its Officers and Directors for certain events or occurrences while the Officer or Director is or was serving at the Company's request in such capacity. The maximum potential amount of future payments is unlimited. However, the Company maintains Director and Officer liability insurance coverage that limits its exposure and enables the Company to recover a portion of any future amounts paid.

In addition, the Company has provided indemnifications to third parties with respect to future site restoration costs to be incurred on properties previously owned by the Company. These estimated costs have been included in the provision for site restoration (Note 10).

**15 COMMITMENTS AND CONTINGENCIES**

**Commitments**

The Company is committed to capital expenditures of \$2,508 (2004 – \$17,987; 2003 – \$1,315) and to future annual payments under operating leases for facility and office space and equipment as follows:

2006	2007	2008	2009	2010
\$763	\$550	\$536	\$188	\$14

**15 COMMITMENTS AND CONTINGENCIES (continued)**

**Contingencies**

The Company and its subsidiaries are party to legal proceedings in the ordinary course of their businesses. Management does not expect the outcome of any of these proceedings to have a material effect on the Company's financial position or operating results.

**16 FINANCIAL INSTRUMENTS**

**Fair value of financial instruments**

The carrying value of the Company's interest in financial instruments approximates their fair value. The estimated fair value approximates the amount for which the financial instruments could currently be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. Certain financial instruments lack an available trading market and, therefore, fair value amounts should not be interpreted as being necessarily realizable in an immediate settlement of the instrument.

**Interest rate risk**

Interest rate risk reflects the sensitivity of the Company's financial results and condition to movements in interest rates. For 2005, a 1% decrease in interest rates would have reduced earnings before income taxes by \$684 (2004 – \$937; 2003 – \$783). Conversely, a 1% increase in interest rates would have increased earnings before taxes by a similar amount.

**Foreign currency risk**

The Company is exposed to currency risks as a result of its export to foreign jurisdictions of goods produced in Canada. These risks are partially covered by purchases of goods and services in the foreign currency and by forward exchange contracts (Note 9).

**Credit risk**

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, short-term investments, accounts receivable, and forward contracts. Cash and short-term investments are placed with major financial institutions or invested in the commercial paper of large organizations. The Company has a concentration of credit risk through its reliance on one customer for Nucryst's wound care products. This risk is limited due to the long-term contractual relationship with this customer.

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**17 EARNINGS PER SHARE**

In calculating earnings per share under the treasury stock method, the numerator remains unchanged from the basic earnings per share calculation as the assumed exercise of the Company's stock options does not result in an adjustment to income. The reconciliation of the denominator in calculating diluted earnings per share is as follows:

	Year Ended Dec. 31, 2005	Year Ended Dec. 31, 2004	Year Ended Dec. 31, 2003
Weighted average number of common shares outstanding – basic earnings per share	92,852,120	84,093,827	78,044,689
Effect of dilutive securities			
– Options	267,078	–	–
– Employee share purchase plan	1,738	–	–
Weighted average number of common shares outstanding – diluted earnings per share	93,120,936	84,093,827	78,044,689

The impact of all dilutive securities on earnings per share was anti-dilutive for the years ended December 31, 2004 and 2003.

Options to purchase 5,049,600 common shares were outstanding at December 31, 2005 (2004 – 4,659,600; 2003 – 5,833,400). Of these options outstanding in 2005, 3,979,100 (2004 – 3,939,100; 2003 – 5,424,700) were excluded in the calculation of diluted earnings (loss) per share because the exercise price of the option was greater than the weighted average market value of the common shares in the year.

**18 SEGMENTED INFORMATION**

The Company has two operating segments, which have been determined based on the nature of the products produced: Nucryst Pharmaceuticals and iFire Technology. Discontinued operations are disclosed separately (Note 4).

The Nucryst Pharmaceuticals segment researches, develops, manufactures and commercializes innovative medical products that fight infection and inflammation, and pharmaceutical products based on noble metal nanocrystalline technology. The iFire Technology segment has developed a proprietary flat-panel full color solid state display technology with applications in the large screen television market.

The accounting policies of the reportable segments are the same as those described in Note 2. Included in other non-cash assets of \$6,914 at December 31, 2005 (2004 – \$8,770; 2003 – \$7,800) are assets that cannot be allocated to a particular segment. Non-cash assets excludes short-term investments and assets available for sale.

Year Ended December 31, 2005	Revenue	Operating Income (Loss)	Depreciation and Amortization	Capital Expenditures	Non-cash Assets Dec.31, 2005
Nucryst Pharmaceuticals	\$ 28,560	\$ 1,590	\$ 1,549	\$ 4,461	\$ 27,315
iFire Technology	–	(31,844)	5,072	24,096	58,605
Other	–	54	717	2,197	6,914
	\$ 28,560	\$ (30,200)	\$ 7,338	\$ 30,754	\$ 92,834

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**18 SEGMENTED INFORMATION (continued)**

Year Ended December 31, 2004	Revenue	Operating Income (Loss)	Depreciation and Amortization	Capital Expenditures	Non-cash Assets Dec.31, 2004
Nucryst Pharmaceuticals	\$ 31,907	\$ 6,079	\$ 1,128	\$ 3,163	\$ 17,476
iFire Technology	–	(27,884)	3,539	18,649	39,378
Other	–	(1,189)	1,055	1,620	8,770
	\$ 31,907	\$ (22,994)	\$ 5,722	\$ 23,432	\$ 65,624

Year Ended December 31, 2003	Revenue	Operating Loss	Depreciation and Amortization	Capital Expenditures	Non-cash Assets Dec.31, 2003
Nucryst Pharmaceuticals	\$ 16,212	\$ (2,014)	\$ 892	\$ 1,827	\$ 12,556
iFire Technology	911	(20,054)	2,693	8,424	20,544
Other	–	(1,333)	1,416	132	7,800
	\$ 17,123	\$ (23,401)	\$ 5,001	\$ 10,383	\$ 40,900

All of Nucryst's revenues are earned through a long-term exclusive licensing agreement with an international wound care company which expires in 2026. Nucryst exports manufactured products to this company for their resale in international markets.

**19 RECONCILIATION TO ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES**

These consolidated financial statements have been prepared in accordance with Canadian GAAP which conform in all material respects with those used in the United States ("U.S. GAAP"), except as set forth below:

**a) Derivative Instruments and Hedging Activities**

Under U.S. GAAP, pursuant to Statement of Financial Accounting Standards ("SFAS") 133 "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), companies are required to record derivatives on the balance sheet as assets or liabilities measured at fair value. For those derivatives representing effective cash flow hedges of risks and exposures, unrealized gains or losses resulting from changes in the fair values are presented as a component of other comprehensive income ("OCI") as defined in SFAS 130 "Reporting Comprehensive Income" ("SFAS 130"). To the extent certain derivatives do not represent effective hedges, unrealized gains or losses are included in the income statement for U.S. GAAP purposes. Derivatives embedded within hybrid instruments are generally not separately accounted for except for those related to equity-linked deposit contracts which are not applicable to the Company.

Hedges against price risk exposure on contracted nickel sales and raw materials purchases in the discontinued Ambeon segment were considered effective cash-flow hedges under SFAS 133. Management regularly measured the effectiveness of these hedges, with unrealized gains and losses reported in OCI for U.S. GAAP purposes. From time to time, the Company reduces its exposure to foreign currency and interest rate fluctuations by entering into forward transactions. These transactions are not considered hedging activities under SFAS 133 and unrealized gains and losses are included in the income statement. As at December 31, 2005 the Company has no adjustments to OCI with respect to cash-flow hedges (December 31, 2004 – recovery \$982; December 31, 2003 – charge \$907).

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**b) Gain on issuance of shares by subsidiary**

In accordance with Canadian GAAP, the Company is required to account for gains and losses on the issuance of shares by a subsidiary as a component of income. Under U.S. GAAP, the effect of such dilution gains may be recorded as income except in circumstances where subsequent capital transactions are contemplated that raise concerns about the likelihood of realizing the gain. In addition, realization of the gain is not assured where the subsidiary is a newly formed, non-operating entity; a research and development start-up; or development-stage company. It is the Company's policy to record dilution gains as a component of income for U.S. GAAP purposes. However, for a transaction in 2001 involving iFire, which at that time was an early stage research and development company, the dilution gain was required to be recorded in equity as an increase in paid-in capital rather than as income. Subsequent dilution gains have met the criteria for income statement recognition under both Canadian GAAP and U.S. GAAP.

**c) Pension**

Under U.S. GAAP, the Company would have recorded an additional minimum liability for underfunded plans representing the excess of the accumulated benefit obligation over the pension plan assets, less the pension liability already recognized and the net unamortized prior service cost. Under SFAS 130 "Reporting Other Comprehensive Income" the increase in liabilities is charged directly to other comprehensive income.

The Company wound up the defined benefit plan in 2003 and there will be no reconciling differences in future years.

**d) Research and Development**

Under U.S. GAAP, the cost of purchased research and development should be charged to income, in the period incurred, when no alternative uses exist for the purchased research and development. As the patents and intellectual property purchased are restricted to use in inorganic electroluminescent displays, the costs have been fully expensed under U.S. GAAP.

Under Canadian GAAP, such costs are capitalized and amortized over their estimated useful lives.

**e) Stock-based Compensation**

U.S. GAAP SFAS 123, "Accounting for Stock-based Compensation" ("SFAS 123"), encourages that stock-based compensation be accounted for based on a fair value methodology. As permitted by the statement, the Company and its subsidiaries have elected to continue measuring compensation costs as the excess, if any, of the quoted market value of the stock at the date of grant over the exercise price.

As the exercise price of options granted by the Company and its subsidiaries is not less than the market value at the date of grant, no compensation expense is recognized.

Under Canadian GAAP, effective January 1, 2004, the Company adopted revisions to Section 3870 of the CICA Handbook which requires that the fair value of stock options be recorded in the financial statements (see Note 2n). These new rules applied to options issued on or after January 1, 2002. As a

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result, the Company has recorded stock-based compensation expense under Canadian GAAP for the year ended December 31, 2005 of \$905 (2004 – \$1,210; 2003 – \$942).

**f) Foreign Currency Translation Adjustments**

Under U.S. GAAP, the Company records unrecognized gains and losses arising from translating net investments in foreign operations into Canadian dollars in accumulated other comprehensive loss as a separate component of shareholders' equity.

Under Canadian GAAP, such unrealized gains and losses are included in shareholders' equity as a cumulative translation adjustment.

The effect of the above differences on the Company's financial statements is set out below:

Consolidated Balance Sheets	December 31, 2005		December 31, 2004	
	Canadian GAAP	U.S. GAAP	Canadian GAAP	U.S. GAAP
Intangible assets (d)	\$ 5,180	\$ 3,180	\$ 5,693	\$ 2,693
Capital stock (e)	421,466	421,347	421,233	421,176
Contributed Surplus (e)	3,968	403	3,125	403
Deficit (b) (d) (e)	(267,291)	(276,116)	(276,561)	(287,291)
Additional paid-in-capital (b)	–	10,509	–	10,509
Accumulated other comprehensive loss (f)	–	(503)	–	–
Cumulative translation adjustment (f)	(503)	–	–	–
<b>Shareholders' Equity</b>	<b>December 31, 2005</b>		<b>December 31, 2004</b>	
Canadian GAAP	\$ 157,640		\$ 147,797	
Adjustments				
Research and development (d)	(2,000)		(3,000)	
U.S. GAAP	\$ 155,640		\$ 144,797	

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	Year Ended December 31		
	2005	2004 (Restated - note 4)	2003 (Restated - note 4)
<b>Consolidated Statements of Operations</b>			
Loss from continuing operations			
Canadian GAAP	\$ (5,508)	\$ (28,734)	\$ (37,849)
Research and development (d)	1,000	(3,000)	–
Stock-based compensation (e)	905	1,210	942
Loss from continuing operations			
U.S. GAAP	(3,603)	(30,524)	(36,907)
Income from discontinued operations			
Canadian GAAP and U.S. GAAP	14,778	3,557	2,409
Net income (loss) applicable to common shareholders			
U.S. GAAP	11,175	(26,967)	(34,498)
Other comprehensive income (loss)			
Pension (c)	–	–	665
Cash flow hedges (a)	–	982	(907)
Foreign currency translation adjustments (f)	(503)	–	–
Net comprehensive income (loss)			
– U.S. GAAP	\$ 10,672	\$ (25,985)	\$ (34,740)

	Year Ended December 31		
	2005	2004	2003
<b>Income (loss) Per Common Share</b>			
<b>Canadian GAAP</b>			
Loss from continuing operations	\$ (0.06)	\$ (0.34)	\$ (0.48)
Net income (loss)	\$ 0.10	\$ (0.30)	\$ (0.45)
<b>U.S. GAAP</b>			
Loss from continuing operations	\$ (0.04)	\$ (0.36)	\$ (0.47)
Net income (loss)	\$ 0.12	\$ (0.32)	\$ (0.44)

Consolidated Cash Flow Statements	Year Ended December 31, 2005		Year Ended December 31, 2004		Year Ended December 31, 2003	
	Canadian GAAP	U.S. GAAP	Canadian GAAP	U.S. GAAP	Canadian GAAP	U.S. GAAP
	Loss from continuing operations	\$ (5,508)	\$ (3,603)	\$ (28,734)	\$ (30,524)	\$ (37,849)
Items not affecting cash:						
Stock-based compensation (e)	\$ 905	\$ –	\$ 1,210	\$ –	\$ 942	\$ –
Depreciation and amortization (d)	\$ 7,338	\$ 6,338	\$ 5,722	\$ 5,722	\$ 5,001	\$ 5,001
Write down of capital assets and intangible assets (d)	\$ 570	\$ 570	\$ 22	\$ 3,022	\$ 723	\$ 723
Changes in items not affecting cash (d)(e)	\$ (26,816)	\$ (28,721)	\$ 7,714	\$ 9,504	\$ 12,978	\$ 12,036

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**Stock-based compensation**

U.S. GAAP, SFAS 123 "Accounting for Stock-Based Compensation" ("SFAS 123") encourages that stock-based compensation be accounted for based on a fair value methodology. As permitted by the Statement, the Company and its subsidiaries have elected to continue measuring compensation costs as the excess, if any, of the quoted market value of the stock at the date of the grant over the exercise price. As the exercise price of options granted by the Company and its subsidiaries is not less than the market value at the date of grant, no compensation expense is recognized.

If compensation costs for the Company's and its subsidiaries' stock option plans had been determined based on the fair value methodology over the vesting period consistent with SFAS 123, including options issued by the Company and its subsidiaries prior to January 1, 2002, the Company's net income (loss) per share would have been reduced to the pro-forma amounts indicated below:

	Year Ended December 31		
	2005	2004	2003
Net income (loss) applicable to common shareholders			
U.S. GAAP	\$ 11,175	\$ (26,967)	\$ (34,498)
Total stock-based employee compensation expense determined under fair-value based method for awards net of tax effects	(905)	(1,040)	(4,518)
Pro forma net income (loss) applicable to common shareholders – U.S. GAAP	\$ 10,270	\$ (28,007)	\$ (39,016)
Loss per common share – U.S. GAAP			
Loss from continuing operations	(0.04)	(0.36)	(0.47)
Net income (loss)	0.12	(0.32)	(0.44)
Pro forma			
Loss from continuing operations	(0.05)	(0.38)	(0.53)
Net income (loss)	0.11	(0.33)	(0.50)

The fair value of each option grant by the Company and its subsidiaries was estimated using the Black-Scholes options pricing model assuming no dividends are to be paid on common shares, a risk free interest rate of 4.33% (2004 – 4.80%; 2003 – 5.05%), an average life of 7.0 years and a volatility for the shares of the companies of 57.72% (2004 – 58.47%; 2003 – 59.89%). The amounts computed according to the Black-Scholes pricing model may not be indicative of the actual values realized upon the exercise of these options by the holders. The weighted average fair value of options granted by the Company and its subsidiaries in 2005 was \$0.75 (2004 – \$1.13; 2003 – \$0.66).

**Recently Adopted and Pending Accounting Pronouncements**

**FSP No. 46(R)-5**

In March 2005, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") No. 46(R)-5, "Implicit Variable Interests under FASB Interpretation No. ("FIN") 46 (revised December 2003), Consolidation of Variable Interest Entities" ("FSP FIN 46(R)-5"). FSP FIN 46(R)-5 provides guidance for a reporting enterprise on whether it holds an implicit variable interest in Variable Interest Entities ("VIEs") or potential VIEs when specific conditions exist. This FSP is effective in the first period beginning after March 3, 2005 in accordance with the transition provisions of FIN 46 (Revised 2003), "Consolidation of Variable Interest Entities – an Interpretation of Accounting Research Bulletin No. 51"

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("FIN 46(R)"). The adoption of FSP FIN 46(R)-5 had no impact on the Company's results of operations or financial position.

**FIN 47**

In March 2005, the FASB issued FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" ("FIN 47"), which clarifies that the term "conditional asset retirement obligation" as used in FASB statement No. 143, "Accounting for Asset Retirement Obligations", refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. An entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. FIN 47 is effective for fiscal years ending after December 15, 2005. The adoption of FIN 47 did not have a material impact on the Company's financial position or results of operations.

**SFAS 123(R)**

In December 2004, the FASB issued SFAS No. 123 (revised 2004) ("SFAS 123(R)", "Share-Based Payment", which is a revision of SFAS No. 123, "Accounting for Stock-based Compensation". SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values and does not allow the previously permitted pro forma disclosure as an alternative to financial statement recognition. Liability classified awards are remeasured to fair value at each balance sheet date until the award is settled. SFAS 123(R) supersedes Accounting Principles Board ("APB") Opinion No. 25 "Accounting for Stock Issued to Employees" and related interpretations and amends SFAS No. 95 "Statement of Cash Flows". SFAS 123(R) is scheduled to be effective beginning fiscal 2006 for the Company. On August 31, 2005, the FASB issued FSP SFAS 123(R)-1 to defer the requirement that a freestanding financial instrument originally subject to SFAS 123(R) becomes subject to the recognition and measurement requirements of other applicable generally accepted accounting principles when the rights conveyed by the instrument to the holder are no longer dependent on the holder being an employee of the entity. On October 18, 2005, the FASB issued FSP SFAS 123(R)2 to provide further guidance on the application of grant date as defined in SFAS 123(R). On November 10, 2005, the FASB issued FSP SFAS No. 123(R)-3 to provide a practical transition election related to accounting for the tax effect of share-based payment awards to employees. The adoption of SFAS 123(R) and the related FSPs will not have a material impact on the Company's financial position or results of operations.

**SFAS 151**

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of ARB No. 43, Chapter 4", which amends Chapter 4 of ARB No. 43 that deals with inventory pricing. The Statement clarifies the accounting for abnormal amounts of idle facility expenses, freight, handling costs, and spoilage. Under previous guidance, paragraph 5 of ARB No. 43, chapter 4, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs might be considered to be so abnormal, under certain circumstances, as to require treatment as current period charges. This Statement eliminates the criterion of "so abnormal" and requires that those items be recognized as current period charges. Also, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This Statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005, although earlier application is permitted for fiscal years

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beginning after the date of issuance of this Statement. Retroactive application is not permitted. The Company does not expect the impact of this Statement to be material.

**SFAS 153**

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Non-monetary Assets", an amendment of APB No. 29. This Statement amends Opinion 29 to eliminate the exception for non-monetary exchanges of similar productive assets and replaces it with a general exception for exchanges of non-monetary assets that do not have commercial substance. The Statement specifies that a non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. This Statement is effective for non-monetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for non-monetary asset exchanges occurring in fiscal periods beginning after the date this Statement is issued. Retroactive application is not permitted. The Company does not expect the impact of this Statement to be material.

**SFAS 154**

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections" ("SFAS 154"), which replaces APB No. 20, "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements – An Amendment of APB Opinion No. 28". SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application, on the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Management believes that the adoption of this statement will not have a material effect on the Company's financial position or results of operations.

**EITF 03-1**

In November 2005, the FASB issued FSP SFAS 115-1 and SFAS 124-1 "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments", which nullified 2004 guidance issued by the Emerging Issues Task Force ("EITF") on determining whether an impairment is other than temporary, and effectively reverted back to previous guidance in this area. The FSP generally encompasses guidance for determining when an investment is impaired, how to measure the impairment loss, and what disclosures should be made regarding impaired securities. This FSP, effective for the first quarter of 2006, is not expected to have a material impact on the Company's results of operations or financial position.

**EITF 03-13**

The EITF issued EITF Abstract 03-13 ("EITF 03-13") to provide guidance on applying SFAS No. 144, "Determining Whether to Report Discontinued Operations" ("SFAS 144"). SFAS 144 discusses when an entity should disclose a "component" as discontinued operations. Under SFAS 144, a component should be disclosed as discontinued operations when continuing cash flows are eliminated and when there is no significant continuing involvement with the component. EITF 03-13 provides additional guidance on factors to consider in evaluating what constitutes continuing cash flows and continuing significant influence. This Statement is effective for fiscal periods beginning after December 15, 2004. The adoption of EITF 03-13 did not have a material impact on the Company's financial position or results of operations.

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**EITF 04-13**

In September 2005, the EITF reached consensus on Issue No. 04-13, "Accounting for Purchases and Sales of Inventory with the same Counterparty" ("EITF 04-13"). EITF 04-13 provides guidance on the purchase and sale of inventory to another entity that operates in the same line of business. The purchase and sale transactions may be pursuant to a single contractual arrangement or separate contractual arrangements and the inventory purchased or sold may be in the form of raw materials, work-in-process, or finished goods. EITF 04-13 applies to new arrangements entered into, or modifications or renewals of existing arrangements in reporting periods beginning after March 15, 2006. The impact of the adoption of EITF 04-13 on the Company's consolidated results of operations and financial condition will depend on the nature of future arrangements entered into, or modifications or renewals of existing arrangements by the Company.

**FASB Exposure Draft "Fair Value Measurements"**

In June 2004, the FASB issued an exposure draft of a proposed Statement, "Fair Value Measurements" to provide guidance on how to measure the fair value of financial and non-financial assets and liabilities when required by other authoritative accounting pronouncements. The proposed statement attempts to address concerns about the ability to develop reliable estimates of fair value and inconsistencies in fair value guidance provided by current GAAP, by creating a framework that clarifies the fair value objective and its application in GAAP. In addition, the proposal expands disclosures required about the use of fair value to re-measure assets and liabilities. The standard would be effective for financial statements issued for fiscal years beginning after November 15, 2006. The Company does not expect the impact of this proposed standard to be material.

**FASB Exposure Draft "Business Combinations"**

In June 2005, the FASB published an exposure draft containing proposals to change the accounting for business combinations. The proposed standards would replace the existing requirements of the FASB's Statement No. 141, "Business Combinations". The proposals would result in fewer exceptions to the principle of measuring assets acquired and liabilities assumed in a business combination at fair value. Additionally, the proposals would result in payments to third parties for consulting, legal, audit, and similar services associated with an acquisition being recognized generally as expenses when incurred rather than capitalized as part of the business combination. The FASB also published an Exposure Draft that proposes, among other changes, that non-controlling interests be classified as equity within the consolidated financial statements. The FASB's proposed standard would replace Accounting Research Bulletin No. 51, "Consolidated Financial Statements". The Company does not expect the impact of this proposed standard to be material.

**FASB Exposure Draft "Accounting for Uncertain Tax Positions"**

On July 14, 2005, the FASB published an exposure draft entitled "Accounting for Uncertain Tax Positions – an interpretation of FASB Statement No. 109". The proposed interpretation is intended to reduce the significant diversity in practice associated with recognition and measurement of income taxes by establishing consistent criteria for evaluating uncertain tax positions.

The proposed interpretation would be effective as of the end of the first fiscal year beginning after December 15, 2006. Earlier application would be encouraged. Only tax positions meeting the probable recognition threshold at that date would be recognized. The transition adjustment resulting from application of this interpretation would be considered a change in accounting policy with the cumulative

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effect of the change treated as an offsetting adjustment to the opening balance of retained earnings in the period of transition. The Company does not expect the impact of this proposed interpretation, if it becomes effective in its current form, to be material.