AC Insights

Insights for reviewing financial reports

Insights on financial reporting using US GAAP

Issue US2021-2
Spring 2021

Contents

When a referenced publication has been underscored, you can link to the actual publication by clicking the link.

Robust COVID-19 disclosures

"We are encouraged by the overall quality of disclosures issuers provided. However, there were some instances where issuers did not provide sufficient detail related to the current and expected impact of COVID-19 on their operations and financial condition, including liquidity and capital resources. It is important that issuers review this guidance closely so that they provide transparent and balanced disclosure."

Louis Morisset, CSA Chair and President and CEO of the Autorité des marchés financiers

The Chair was commenting on the findings of a review of disclosures by the CSA staff, indicating that the majority of issuers provided detailed, quality disclosures in their financial statements, MD&A, and other disclosure documents. These findings are encouraging, but we are not through the pandemic yet.

For over a year now, businesses have faced many challenges as they managed the health and economic crises. These challenges continue as we face variants of concern, potentially causing a third challenging wave, and questions about the supply, efficacy, and acceptance of vaccines. While many businesses have innovated and adapted to these challenges, some have not been as fortunate. The containment of the virus, reducing containment measures and the economic recovery are intricately linked; however, some businesses may not benefit from the recovery. Just as the pandemic has been a major disruptor, many economists expect that there will continue to be geopolitical, technological, and societal disruptors as we move into a period of economic recovery. Public companies will have to keep up their vigilance and provide robust entity-specific disclosures about the consequences of COVID-19 and the post-COVID economic recovery.

The CSA staff completed a review of interim period disclosures by 90 reporting issuers (34% were Venture issuers and 66% were non-Venture issuers) on the impact of COVID-19 on their businesses particularly those disclosures about matters involving significant judgments and measurement uncertainties. The key findings of the review were published in February 2021 in the CSA Staff Notice 51-362: *Staff Review of COVID-19 Disclosures and Guide for Disclosure Improvements*.

The CSA staff noted disclosures that were beneficial to investors and areas for improvements. The Staff Notice encourages issuers to avoid boilerplate disclosures about the impact of COVID-19 and provide information about entity-specific trends and risks such as credit and liquidity risks. Some disclosures of non-GAAP financial measures (NGMs) and forward-looking information (FLI) were not compliant with the requirements.

What did issuers report

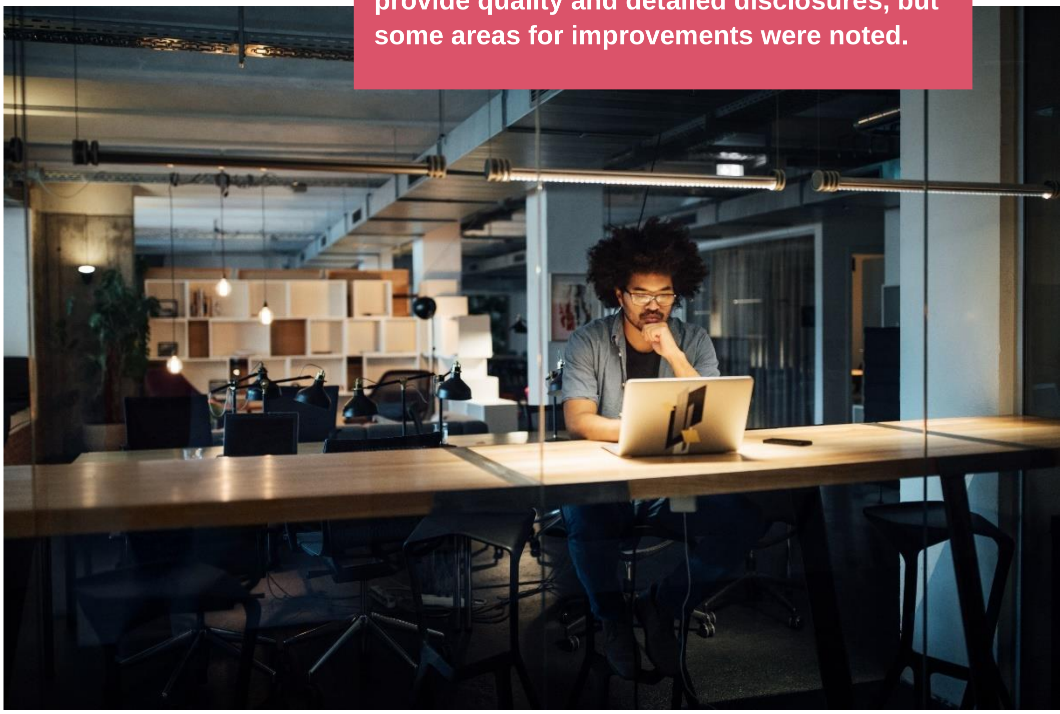
Issuers reported COVID-19 implications affecting:

- Their operations—changes in demand for products and services, modifications to operations for health and safety requirements, constraints on people, closures, disruptions of supply chains or distribution channels, changes in prices, changes in terms with customers, and curtailment of capital projects.
- Their financial condition and performance—changes in revenues, restructuring charges, asset impairments, credit losses, changes in fair values of assets and liabilities, changes in expenses, negative working capital positions, negative cash flows from operations, and material uncertainties about the ability to continue as a going concern.
- Their actions to manage operations and liquidity—using government assistance programs, changing the mix of products and services provided, reducing discretionary expenses, changing amounts and timing of capital projects, decreasing employee compensation, laying-off employees, modifying payment terms to suppliers and vendors, arranging new financing, amending credit agreements, changing policies for dividends and distributions, suspending share buybacks, disposing of assets, adding oversight measures, and implementing business continuity plans.

MD&A

MD&A is a narrative explanation of the issuer's performance, financial condition, and future prospects. The MD&A complements and supplements an issuer's financial statements. The objective of MD&A is to provide a balanced discussion of the issuer's financial performance and financial condition, including its liquidity and capital resources. The MD&A should openly report bad news as well as good news. Form 51-102F1: *Management's Discussion & Analysis* sets out the MD&A requirements.

Many issuers took proactive measures to provide quality and detailed disclosures, but some areas for improvements were noted.



Many issuers provided operational and liquidity updates and took impairments on assets to respond to the consequences of COVID-19. While the CSA staff applauded issuers for taking proactive measures to provide quality and detailed disclosures, some areas for improvements were noted. We believe these matters are also relevant to reporting issuers preparing their financial statements using US GAAP.

- **Operational status of business**
  - What worked well: Some issuers provided an expanded discussion and analysis to explain the impact of COVID-19 on the issuer's industry, operations, customers, suppliers, and so on. Several issuers included industry and operational information to understand the effects on their financial statements.
  - What can be improved: Providing an overview section can help investors understand the issuer's financial condition, performance, and liquidity. An overview might include the impact of COVID-19 consequences on the industry and the issuer – its operations, the demand for and the ability to deliver its products and services, the closure of and restrictions on its operations, and customers' and suppliers' responses to the status of its operations. The discussion should focus on both the issuer's segments and geographic locations if material.
- **Response to COVID-19**
  - What worked well: A narrative disclosure of measures taken by issuers provided insights into (1) the issuers' response to COVID-19 that had material impacts on current operations and future performance, and (2) the anticipated duration of such measures in the future.
  - What can be improved: Issuers should provide sufficient detail about the cost and savings resulting from operational changes made in response to the pandemic and include an adequate discussion of these measures' anticipated impact.
- **Analysis of operations**
  - What worked well: Some issuers provided information to understand the impact of COVID-19, such as:
    - Retail/service industry: details of store closures, number of weeks the outlets were operating, e-commerce sales versus in-store sales.
    - Investment property industry: an analysis of leases that were affected negatively or positively or unaffected by the pandemic; and the proportion of tenants that applied for government assistance.
  - What can be improved: Issuers should supplement general statements attributing negative results to COVID-19 with the issuer-specific impacts on revenue and expenses by segment. Issuers should distinguish between consequences resulting from COVID-19 and those resulting from pre-existing or other conditions, explaining how the amounts attributed to COVID-19 were determined. The impact of government assistance should be discussed and quantified to provide a balanced discussion of material factors affecting operations. Factors to consider include the change in demand for products and services, operational closures, changes in costs, changes to terms with counterparties, credit losses and impairments of assets, government assistance received, restructuring costs, and terminations or modifications of contracts.
- **Known trends and events that are reasonably likely to affect future performance**
  - What worked well: An "outlook" section helped to understand the anticipated medium to longer-term impact of the current pandemic and post-pandemic consequences to the industry and the business.
  - What can be improved: Issuers should avoid boilerplate and provide comments on any impacts that may continue post-pandemic, how future operations may be affected differently compared to the current period, the potential for material restructurings, and future plans of recovery post-COVID-19.
- **Liquidity and capital resources**
  - What worked well: Some issuers disclosed remedies available to address liquidity uncertainties. In the investment properties industry, disclosures about the number of tenants restructuring leases, rents received during the period, and a risk profile for tenants were considered helpful to understand the issuer's liquidity risks and future trends.
  - What can be improved: Issuers should include a comprehensive discussion of the initiatives to manage current and expected liquidity and funding risks. The disclosures may consist of the current working capital amount, working capital needs, significant obligations coming due, cash burn rates, changes in capital projects, and how operations and projects are and will be funded. Other factors to consider are changes made in debt or lease arrangements, delayed payments to vendors and suppliers, suspension of dividend and distribution payments, sources of financing, and other management plans to support liquidity needs.

- **Debt covenants**
  - What worked well: Beneficial disclosures were those to understand (1) current debt covenants, including quantitative disclosure of covenant terms and related compliance, and (2) amendments to credit facilities, including changes in terms of covenants, covenant waivers, and additional restrictions placed on the borrower.
  - What can be improved: Issuers' discussions should include the terms and conditions of debt covenants, especially when a breach of covenants has occurred that could require a material funding requirement or repayment. Disclosures of terms and conditions of debt arrangements may be necessary if a violation of covenants or terms could be triggered.
- **Risk factors**
  - What worked well: Certain issuers made disclosures of risk factors distinguishing between short-term risks and anticipated longer-term risks.
  - What can be improved: Rather than a generic list of risks, risks disclosed should be entity specific. Prioritizing risks and identifying the duration of risks helps investors understand the importance of the risks. Significant risks warranting disclosure might be disruptions due to health and safety concerns or government lock-downs, staffing constraints, cybersecurity and technology risks, sustainability of revenue and cash flows, the impact of customer demand and customers' ability to pay, reliance on significant customers, ability to acquire materials and supplies, potential volatility in costs of materials and supplies, access to government assistance, requirements under lending agreements, access to capital markets or other sources for financing, potential litigation resulting from the pandemic, and unique issues related to the ability to recover from the pandemic.

The Staff Notice provides illustrative examples of deficient and improved disclosures for scenarios related to the discussion of (1) operations and impact of COVID-19, (2) measures to reduce the impact of COVID-19, (3) liquidity and capital resources, and (4) risk factors.

Financial statements

Financial statements are the cornerstone of financial reporting. COVID-19 has affected many businesses in different ways. Many companies have had to make judgments and estimates when preparing their financial statements to reflect the pandemic's consequences. These consequences have resulted in a higher degree of uncertainty in making reasonable and supportable judgments and estimates used in preparing financial statements.

Many disclosures in the financial statements were robust, but some needed improvements to be entity-specific and complete.

The CSA staff noted many disclosures in the financial statements were robust, but some needed improvements to be entity-specific and complete. The key highlights of the comments made for financial statements prepared using IFRSs are set out below. We have augmented the CSA discussion to reflect US GAAP requirements for each topic of concern.

- **Going concern**
  - What worked well: Robust disclosures of material uncertainties were made by some issuers when uncertainties may cast doubt on the issuer's ability to continue as a going concern.
  - What can be improved: For "close call" situations, issuers should disclose the judgments made in reaching their conclusions that the entity is a going concern. Some issuers breached covenants on their debt but did not (1) reclassify the debts to current when the obligations were callable, or (2) disclose material uncertainties that may cast doubt about the issuers' abilities to continue as going concerns. When waivers or changes in the terms of the debt arrangements were obtained, issuers should have assessed whether the debt had been extinguished. Extinguishments and replacement of existing debt may result in changes to the accounting and disclosures.

- US GAAP considerations: The ASC does not have any specific disclosures for going concern issuers; however, the PCAOB standards provides matters any auditor should consider such as conditions or events giving rise to substantial doubt about going concern, effects of those conditions and events, management's evaluation of the situation and mitigating factors, management's plans, and the effect on recoverability and classification of assets and classification of liabilities.

- **Significant judgments and measurement uncertainties**
  - What went well: Several issuers provided updates of significant judgments made and measurement uncertainties for impairments and going concern assessments. Some stated that there were no significant changes in judgments and estimates.
  - What can be improved: Issuers should provide entity-specific information about judgments and measurement uncertainties, including the expected resolution of the uncertainties or a range of reasonably possible outcomes. While some made disclosures in the MD&A, they overlooked the requirement to update the interim financial statements' disclosures.
  - US GAAP considerations: US GAAP does not have an overarching requirement to disclose significant judgments made in applying accounting policies or sources of significant estimates. Certain specific standards may require some disclosures about estimates.

- **Impairment of financial assets**
  - What worked well: Issuers made various disclosures of the increased level of credit risk by asset class, updates of critical assumptions used in expected credit loss models, and management strategies to reduce credit risks. Some included sensitivity analysis to show the possible impact of changes in multiple assumptions on expected credit losses or changes in their loan portfolios' characteristics. Some issuers disclosed increased expected credit losses, while others explained that the pandemic consequences did not affect the financial assets' credit quality. Many issuers discussed the impact of loan payment deferrals and the impact of expected credit losses.
  - What can be improved: When entities have significant receivable balances, disclosures should include allowances for expected credit losses or updates of their expected credit losses due to COVID-19. While models to estimate expected credit losses may not incorporate the pandemic's specific effects, issuers may need to consider and disclose the use of model overlays or adjustments. Issuers should consider using multiple scenario analyses, assumptions reflecting the different challenges to specific sectors or regions, and disclosures about loan payment deferral programs.
  - US GAAP considerations: The CECL model applies to financing receivables, held-to-maturity securities, trade accounts receivable, net investments in leases, and certain other financial assets. While the CECL model differs from the IFRS model, preparers using US GAAP will also need to assess how the consequences of COVID-19 are reflected in their measurement of losses. US GAAP requires entities to disclose the allowance for loans losses and doubtful accounts.

- **Impairment of nonfinancial assets**
  - What worked well: Issuers recorded impairment adjustments when necessary. They disclosed the reasons such as reduced demand for products and services and increased costs or disruptions related to their supply chain.
  - What can be improved: General statements that an impairment resulted from adverse economic impacts of COVID-19 should be supported with entity-specific information about the indicators and their impact. Disclosures should be made of the changes to key assumptions in estimating the recoverable amount of assets.

- US GAAP considerations: While nonfinancial assets that are not recoverable are written down to fair value under US GAAP, the types of disclosures are similar: facts and circumstances leading to the impairment, and methods used to determine fair value, techniques and assumptions used, and other relevant fair value measurement disclosures.

- **Leases**
  - What worked well: Most entities applying the practical expedient permitted by the IASB met the criteria for the use of the exceptions to lease accounting for rent concessions.
  - What can be improved: Some entities did not disclose that they elected the practical expedient and other related disclosures of the election.
  - US GAAP considerations: US GAAP permits similar accommodations for rent concession and required disclosures of material concessions received and the accounting effects.
- **Investment properties**
  - What can be improved: Investment properties are carried at fair value. Issuers need to provide information about the valuations, the inputs to the valuations, reasons for changes in the valuation, and a narrative about the sensitivity of Level 3 inputs for fair values.
  - US GAAP considerations: Investment properties are carried at cost and would be subject to the requirements for impairment of nonfinancial assets.
- **Government assistance**
  - What worked well: Several entities disclosed they had received or expected to receive government assistance.
  - What can be improved: Some entities did not provide information on government assistance in their notes. IFRS requires disclosure of the accounting policies used for government assistance, the nature and extent of assistance recognized, and unfulfilled conditions and contingencies related to the aid. Disclosures about the terms and conditions for forgivable loans are also required.
  - US GAAP considerations: US GAAP does not have a standard on government assistance. Reference is often made to IFRSs for guidance.
- **Financial instruments risks**
  - What can be improved: While issuers updated their liquidity, market, and credit risks disclosures in the MD&A, some did not provide entity-specific disclosures in their financial statements. Disclosures about credit risks and liquidity risks should be updated when necessary.
  - US GAAP considerations: US GAAP requires disclosures of concentration of credit risks and market risks for financial instruments.

The Staff Notice provides illustrative examples of deficient and improved disclosures for scenarios related to the impairment of nonfinancial assets, going concern, and government assistance.

Non-GAAP financial measures

While only a few issuers made COVID-19 adjustments to their NGMs, some did not explain how the adjustments were attributable to the pandemic or nonrecurring. In a few instances, the CSA staff noted the NGMs were potentially misleading because adjustments were made for expenses related to COVID-19 but not for government assistance received. In other cases, issuers attempted to normalize results based on positive results in one quarter. Staff Notice 52-306: *Non-GAAP Financial Measures* outlines the CSA staff expectations on adjusting NGMs for COVID-19 related items.

The Staff Notice provides an illustrative example of deficient and improved disclosures for NGMs.

Forward-looking information

Most issuers withdrew previously issued FLI. Some issuers added outlook sections discussing the anticipated impact of COVID-19 in the medium to long term. The rapidly changing environment makes it essential for issuers to update the MD&A for events and circumstances reasonably likely to cause actual results to differ from previously disclosed FLI.

Other regulatory disclosures

Many issuers issued updates through press releases, but few issued material change reports even when there were unique or more significant changes to their business, operations, or capital resources. Examples of potential events or circumstances that may give rise to a material change are changes in distributions or dividends, changes in credit arrangements, significant disruptions to the workforce or operations, adverse changes in markets, economy, or laws, critical supply chain delays or disruptions, increased costs, and suspension of exports.

The Staff Notice provides insights into the CSA staff's expectations about disclosures related to the COVID-19 consequences. Issuers should carefully consider which comments are relevant to their circumstances and review their disclosures to assess whether improvements can be made to inform investors of how COVID-19 and the recovery have and may affect the issuer. It is expected the CSA staff will continue to monitor the disclosures as companies continue to face the challenges of COVID-19 and the recovery from the pandemic.

US GAAP update

The FASB met several times during the quarter ended March 31, 2021. One ASU was issued to address implementation issues with reference rate reform. The status of current standard-setting projects is outlined in the table at the end of this section.

Reference rate reform and derivatives discounting transition

With the cessation of LIBOR and other interbank offered rates approaching, the FASB issued new guidance to facilitate the shift away from LIBOR and IBORs when existing accounting requirements may have unintended consequences. In March 2020, the FASB issued ASU 2020-04: *Reference Rate Reform – Facilitation of the Effects of Reference Rate Reform on Financial Reporting.* The new guidance, which is codified in ASC Topic 848: *Rate Reference Reform,* provides optional relief permitting less accounting analysis and less accounting recognition of modifications related to reference rate reform.

The derivatives market is currently transitioning derivative instruments to alternative rates. Exchange margin payments based on changes in the derivatives instrument's fair value may also be affected by a shift in the interest rate used for discounting. Further, the compensation or interest amount earned on margin payments referred to as contract price alignment typically fluctuates with changes in an interest rate index and may also be affected by a shift in the interest rate used for that purpose. Concerns were raised about the accounting consequences when the referenced rates for discounting were not discontinued but were affected by reference rate reform.

In January 2021, the FASB made amendments to ASC Topic 848 through ASU 2021-01: *Reference Rate Reform – Scope,* which clarified the scope of ASC Topic 848 to include derivatives affected by a change in the interest rate used for margining, discounting, or contract price alignment that do not reference to LIBOR or another reference rate expected to be discounted. This guidance is effective immediately.

The amendments clarify that specific optional expedients and exceptions in ASC Topic 848 for contract modifications and hedge accounting apply to derivatives affected by the discounting transition. Further, the FASB clarified that a receive-variable-rate, pay-variable-rate cross-currency interest rate swap may be considered an eligible hedging instrument in a net investment hedge if both legs of the swap do not have the same repricing intervals and dates as a result of reference rate reform.

The guidance has optional transition provisions. Further, the ASU has limited application and effectively lapses on December 31, 2022.

FASB Standard Setting Projects

The table sets out current standard setting projects of the FASB and the status of these projects.

Project	Objective	Status
Identifiable intangible assets and subsequent accounting for goodwill	Reconsider the subsequent accounting for goodwill and identifiable intangible assets.	
Disclosure framework: Disclosure review of: • **Income taxes** • **Inventory** • **Interim reporting**	Improve the effectiveness of disclosures in the notes to the financial statements by facilitating clear communication of the information required by GAAP that is most important to users of the financial statements.	Various stages
Disclosure improvements in response to the SEC's release on disclosure update and simplification	Determine whether and how SEC disclosure requirements referred to the FASB should be incorporated into the ASC.	
Disclosure of supplier finance programs involving trade payables	Develop disclosure requirements to enhance transparency about the use of supplier finance programs involving trade payables.	
Disclosures by business entities about government assistance	Develop disclosure requirements about government assistance to improve the content, quality, and comparability of financial statements and that are responsive to emerging issues.	
Financial performance reporting – disaggregation of performance information	Improve decision-usefulness of the income statement through the disaggregation of performance information.	
Segment reporting	Improve the segment aggregation criteria and disclosures.	
Simplifying the balance sheet classification of debt	Provide guidance to reduce the cost and complexity of determining current versus noncurrent classification of debt.	

Legend for status

Added to agenda, planning and research	Initial deliberations and tentative conclusions	Exposure Draft issued or to be issued	Feedback analysis and refinement	Final standard issued

CSA regulatory update

Focus on issuers mining, holding, and trading crypto assets

Reporting issuers may deal with crypto or digital assets, including cryptocurrencies, tokens, stablecoins, and similar digital assets. A CSA analysis of issuers with crypto assets indicated that crypto mining, investment, and blockchain technology companies primarily hold these assets. Mining is the process of acquiring cryptocurrencies using powerful computers and specifically designed software.

Given this industry is in the early stages of development, the CSA issued CSA Staff Notice 51-363: *Observations on Disclosure by Crypto Assets Reporting Issuers* to provide observations and guidance on disclosures for issuers mining, holding, and trading crypto assets. The Staff Notice was issued in March 2021.

Safeguarding crypto assets

A material risk for crypto assets is the risk of loss or theft. The CSA is putting a strong focus on disclosures about how crypto assets are safeguarded. The types of controls to protect crypto assets from theft or loss may vary depending on the nature and size of the portfolio of assets and the frequency of moves and liquidations of assets.

An issuer may hold its own crypto assets. In this case, the CSA expects disclosure, if material, of the controls to safeguard the assets and private keys, the extent of using multi-signature wallets, the nature of insurance coverage, the measures to mitigate cybersecurity risks, and the frequency of monetizing crypto assets into fiat currency.

Third-party custodians or trading platforms may hold an issuer's crypto assets. In these situations, the CSA expects information, if material, about the service provider. Details about the service provider would include its identity and location, the services provided to the issuer, its status as a regulated or unregulated financial institution, and its status as a related party to the issuer. Disclosures may also be required to describe any issues in the service provider's financial operations, any known security breaches or incidents at the service provider, and protections for the issuer if the service provider enters bankruptcy. Other information considered important is the quantity or percentage of the issuer's crypto assets held by the service provider, the issuer's insurance coverage for losses, and the nature and extent of due diligence undertaken to assess any service provider located or operating in foreign jurisdictions.

Non-monetary transactions involving the exchange of cryptocurrencies, particularly with related parties, have an increased risk of manipulation. Robust controls should be designed to initiate and approve these transactions, minimize the time to settle transactions, and ensure appropriate segregation of duties.

Other important disclosures

The Staff Notice also highlights disclosure requirements for:

- The description of the business to allow investors to fully understand the nature of the operations, including how revenue will be generated, specialized skills and knowledge held, competitive factors, availability of equipment, and reliance on third parties.
- Risk factors including cost and availability of electricity, price volatility of crypto assets, and access to assets held by third parties.
- Material changes including new third-party custodial arrangements, loss or theft of crypto assets, acquisition or disposal of mining equipment, new mining pooling arrangements, and new electrical supply arrangements.
- Information about the crypto assets' portfolio, similar to that required for investment funds that report if material, concentrations, restrictions, and specific information about holdings.

Financial statements

Accounting for crypto assets may present complex and novel accounting and disclosure issues. The IFRS Interpretation Committee (IC) has issued references to existing IFRSs for accounting for cryptocurrencies. Neither the IASB nor the FASB has issued any guidance on specific accounting for crypto assets other than the IC guidance. The AICPA has developed a practice aid on how to account for digital assets. This nonauthoritative guidance in *Accounting for and auditing digital assets* is based on US GAAP but may be a reference for accounting for digital assets when companies using IFRSs need to develop their accounting policies.

For cryptocurrencies, the Staff Notice outlines some considerations for issuers:

- The IC issued an agenda decision, *Holding of Cryptocurrencies,* in June 2019. The IC noted that IAS 2: *Inventories* applies to cryptocurrencies held-for-sale in the ordinary course of business; otherwise, IAS 38: *Intangible assets* applies. Issuers in mining cryptocurrencies may need to use judgment to develop accounting policies for their participation in mining pools and the sale or rent of "hash" power to other entities. Hash power or hash rate is the speed or total processing power of the cryptocurrency network, representing the productivity and efficiency of the computing equipment used. For more information on the IC guidance, PwC has provided an in-depth look at the issue in its publication *Cryptographic assets and related transactions: accounting considerations under IFRS*.
- Assets held to mine cryptocurrencies may be subject to technological obsolescence. Issuers should consider any potential impairment of such assets as required under IAS 36: *Impairment of assets,* as well as any revisions to useful lives of assets. Factors affecting the recoverable amount may include the sustainability of cryptocurrency values, energy prices, other cash flows related to mining activities, the issuer's hash rate compared to competitors, and the need to sustain capital expenditures to maintain a consistent level of hash power relative to other miners.
- Specific disclosures required under IFRSs would apply to cryptocurrencies held by an issuer, as well as any additional information to understand the financial statements. The CSA staff noted that information that may be relevant includes accounting policies for the assets; the nature, risk exposure, quantity, and value of the different types of cryptocurrencies held; a reconciliation of balances showing changes due to mining, market acquisitions, market disposals, and other causes; source of valuation data; breakdown of equipment by cryptocurrency mining capability; related party transactions; and fees received for various mining activities.
- IFRS 13: *Fair Value Measurement* applies to cryptocurrencies measured at fair value. Issuers should consider, if material, disclosures of valuation techniques used, the fair value measurement's categorization in the fair value hierarchy, and any realized and unrealized gains included in results.

The Staff Notice will assist issuers mining, holding, or trading crypto assets in preparing their disclosures. These issuers should carefully read the guidance as we expect the CSA staff will continue to monitor the disclosure of these issuers and other developments in the industry.

Crypto assets trading platforms subject to regulatory oversight

On March 29, 2021, the CSA and the Investment Industry Regulatory Organization of Canada (IIROC) published a notice, Joint CSA and IIROC Staff Notice 21-329: *Guidance for Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements*, setting out the applicable securities law requirements that apply to crypto asset trading platforms (CTPs).

The Notice applies to CTPs that facilitate the trading of crypto assets that are securities or instruments or contracts involving crypto assets. The Notice does not introduce new rules for CTPs but instead provides guidance on how existing rules may be tailored to CTPs and imposed when CTPs register or are recognized. This framework will bring appropriate regulatory oversight to CTPs. The framework categorizes CTPs as either Dealer Platforms or Marketplace Platforms. Dealer Platforms are ones in which the CTP only facilitates the primary distribution of security tokens and is a counterparty to each trade. Dealer Platforms will apply to register with securities administrators as restricted dealers. Marketplace Platforms maintain or provide a market or exchange for buyers and sellers of security tokens and crypto contracts, bring together orders from buyers and sellers, and fulfil the orders through trades. Marketplace Platforms will need to apply as an investment dealer.

The OSC has also notified crypto asset trading platforms that currently offer trading in derivatives or securities in Ontario that they must bring their operations into compliance with Ontario securities law or face potential regulatory action. Crypto asset trading platforms must contact the OSC staff by April 18, 2021, to discuss how they will comply with Ontario securities requirements.

The OSC indicated that it is aware of platforms seeking to become reporting issuers through IPOs, reverse take-overs, changes of business, Capital Pool Company qualifying transactions, or similar transactions. The OSC noted that there are potential public interest concerns with a platform that is required to be registered, but that is not, becoming a reporting issuer.

CTPs should carefully review the framework published by the CSA and consult with their professional advisors as to the next steps in meeting the securities law requirements.

Companies gradually increasing representation of women

In March 2021, the CSA published its latest report on the status of women on boards of directors and in executive officer positions at Canadian public companies. *The CSA Multilateral Staff Notice 58-312: Report on Sixth Staff Review of Disclosure Regarding Women on Boards and in Executive Officer Positions* highlights key trends based on the review of filings by 610 issuers with year-ends between December 31, 2019, and March 31, 2020.

The CSA has been considering its role in the broader diversity conversation and will continue to engage with issuers, investors and other stakeholders on this topic.

The CSA Chair, Louis Morisset, commented that, "the CSA has been considering its role in the broader diversity conversation and will continue to engage with issuers, investors and other stakeholders on this topic".

Key trends noted in the report are outlined in the table on the next page.

Table of key trends for representation of women in public companies

	2017-2018	2018-2019	2019-2020
Board seats			
Held by women	15%	17%	20%
At least one woman on board	66%	73%	79%
Three or more women on the board	13%	15%	20%
Chair position held by a woman	n/a	5%	6%
Board vacancies filled by women	29%	33%	30%
Policies on the representation of women on issuer's board	42%	50%	54%
Targets for women on issuer's board	16%	22%	26%
Executive officers			
At least one woman in an executive position	66%	64%	65%
CEO position held by a woman	4%	4%	5%
CFO position held by a woman	14%	15%	15%
Targets for women in executive positions	4%	3%	4%
Board renewal			
Term limits for directors	21%	23%	23%
Other policies			34%
No policies			39%

For the latest year, 21% of issuers did not have any women on their board, and 35% of issuers did not have any women in executive positions. The Staff Notice provides further data on women's representation based on the issuer's size and industry of issuer.

Term limits were based on different factors such as age (44%, prior year 44%), tenure (28%, prior year 25%), and both age and tenure (28%, prior year 31%). The average age of board members was 73 years, and the average tenure was 13 years, basically unchanged from the prior two years. Other policies mentioned by issuers include assessments of the board and individual members.

The CSA will be providing the complete data supporting the report later in the spring of 2021.

Best practices for confidential pre-filing of a prospectus in Ontario

The OSC permits issuers to confidentially pre-file a prospectus to assist in their capital-raising efforts. As a result of an increase in pre-filings, the OSC staff have issued the following best practices to streamline the review process:

- All financial and non-financial disclosures that would be included in the actual prospectus filing must be included. Missing disclosures can result in review timelines being extended.
- A deal timeline should be included in the filing cover letter. The OSC staff expects the issuer to file a preliminary prospectus shortly after completing the pre-filed prospectus review.

- Any legal or accounting questions requiring OSC staff input should be highlighted.

The OSC will not review pre-files of:

- Non-offering prospectuses, other than non-offering prospectuses connected with cross-border financing or where there is a specific legal or accounting matter requiring staff input.
- Prospectuses to qualify the issuance of securities on the conversion of convertible securities, such as special warrants.

The OSC staff will triage all filings and prioritize the most urgent and time-sensitive prospectus filings, such as bought deals and overnight marketed offerings. If the timelines are less pressing, the review timelines may be extended with notifications to the issuer and their legal counsel.

Short-term liquidity concerns may affect prospectus offerings

Securities legislation prohibits a securities administrator from issuing a receipt for a prospectus if it appears the proceeds from the offering, along with the issuer's other resources, are insufficient to accomplish the purpose set out in the prospectus. A prospectus discloses the intended use of proceeds from the offering and the issuer's financial condition, including liquidity concerns. Relevant disclosures may include negative cash flows from operations, negative working capital, net losses, and significant going concern issues.

A receipt for a prospectus may be refused if the issuer lacks sufficient funds to continue operations or if the proceeds of the offering are insufficient to accomplish the stated purpose of the offering. In March 2021, the CSA issued CSA Staff Notice 41-307(Revised): *Concerns regarding an Issuer's Financial Condition and the Sufficiency of Proceeds from a Prospectus Offering* to alert issuers of the CSA staff's approach in dealing with these situations. The original guidance issued in 2012 has been updated.

The CSA staff will consider proceeds from an offering to be insufficient if the funds to be raised are not sufficient to meet the issuer's short-term liquidity needs. Short-term liquidity needs should be sufficient to fund the completion of the next phase or milestone of a project or to continue operations in the short-term, generally 12 months, for issuers with active operations.

A receipt for a prospectus may not be issued if:

- It appears the prospectus does not adequately disclose the issuer's financial condition or going concern risk; or
- The disclosure of the financial condition is adequate, but it appears the proceeds are insufficient, and it is not in the public interest to issue a receipt.

In their review of prospectuses, the CSA staff have identified five issues that will likely raise comments.

- Information regarding the offering amount and pricing is missing. The size of the offering is necessary to assess whether the proceeds are sufficient. If the preliminary prospectus is filed without the offering amount and pricing, the CSA staff will request a blackline version of the draft form of the final prospectus before they can clear the final prospectus. If it is not practicable to provide the information, an issuer may provide an estimate or range of the required figures. The CSA staff may also request green sheets to make their assessments.
- When there are questions about the issuer's financial condition or the proceeds, and the offering structure appears insufficient to meet the offering's stated purpose. The use of a base shelf prospectus may be considered inappropriate given the issuer's financial condition or the financing's uncertainty. Issuers can expect additional questions on the rationale for filing the base shelf prospectus, the nature and timing of the prospectus supplement and offerings, sources of other financings, and the issuer's plan of operations for the next 12 months. Issuers may be requested to file a short-term prospectus with a minimum subscription amount or a fully underwritten commitment and arrange additional financing sources.
- The use of proceeds disclosure is inadequate. Disclosure may be inadequate when:
  - The principal purpose of the proceeds is overly general without breakdowns by phase of the project and the nature of the expenditures. The use of proceeds may need to reflect both minimum and maximum subscriptions.
  - The business objective and significant milestones or events to be achieved, including the costs and timing, are not disclosed.

- The use of proceeds section does not disclose that the issuer had negative cash flows from operations in its most recently completed financial year and the extent to which any of the proceeds will be used to fund any expected negative cash flows from operations in future periods. Negative operating cash flows must also be disclosed as a risk factor. Disclosures may also be requested about the issuer's most current working capital amount, the issuer's cash burn rate, the period that any proceeds of the offering will be used to fund operations, and any significant debt obligation maturing in the short term.

- Boilerplate risk factors are disclosed about an issuer's financial condition. The disclosure should disclose uncertainties that may raise concerns about the issuer's ability to continue as a going concern and how it addresses that risk. Risk disclosures should disclose negative cash flows from operations and the risks associated with a best effort offering without a minimum subscription amount.
- Issuer's representations of the number of months it will continue its operations given its financial condition. Proceeds from the offering are only considered if the offering is a bought deal, there is a minimum offering amount or a stand-by commitment, or there is an alternative financing arrangement with certain proceeds. The issuer's representations are generally disclosed in the prospectus. In certain circumstances, the CSA staff may ask issuers to support the assumed period of liquidity by providing a summary cash flow forecast and disclose all or portions of the summary cash flow forecast in the prospectus. Such disclosure may need to comply with the requirements for future-oriented financial information and forward-looking information.

Issuers that may be stretched by the current environment may turn to the capital markets to provide much-needed financing. While the CSA fosters capital-raising activities for companies, these measures are focused on ensuring companies raising funds from the public can sustain their operations and achieve their business objectives.

Security compensation plans for TSX listed companies

In March 2021, the Toronto Stock Exchange (TSX) published an updated *Guide to Security Based Compensation Arrangements* (the Guide). The TSX has noted that executive compensation and security-based compensation plans continue to grow in complexity and are under increased scrutiny by various stakeholders. The Guide is intended to help listed issuers better understand the issues relating to security-based compensation arrangements and assist listed issuers in preparing meaningful disclosure that complies with TSX requirements.

The Guide provides TSX guidance on:

- The regulatory approach for security-based compensation arrangements, including TSX review requirements, approvals required for plans, mandatory terms to be included in plans, and discretionary terms permitted in plans.
- Disclosures for security-based compensation arrangements required annually and upon adoption and amendment of a plan, together with examples.
- Monthly and quarterly reporting requirements to the TSX.
- Special requirements for anti-dilution provisions, secondary security purchase plans administered by non-independent trustees, backdating of stock options, and plans of arrangement and reorganizations.
- Frequently asked questions.

SEC regulatory update

SEC focus on climate change and ESG issues

The SEC opened several initiatives to assess and update disclosures about climate change and ESG issues. These initiatives are driven by the demand for climate change information and questions about whether current disclosures are sufficient to inform investors about climate change issues facing registrants.

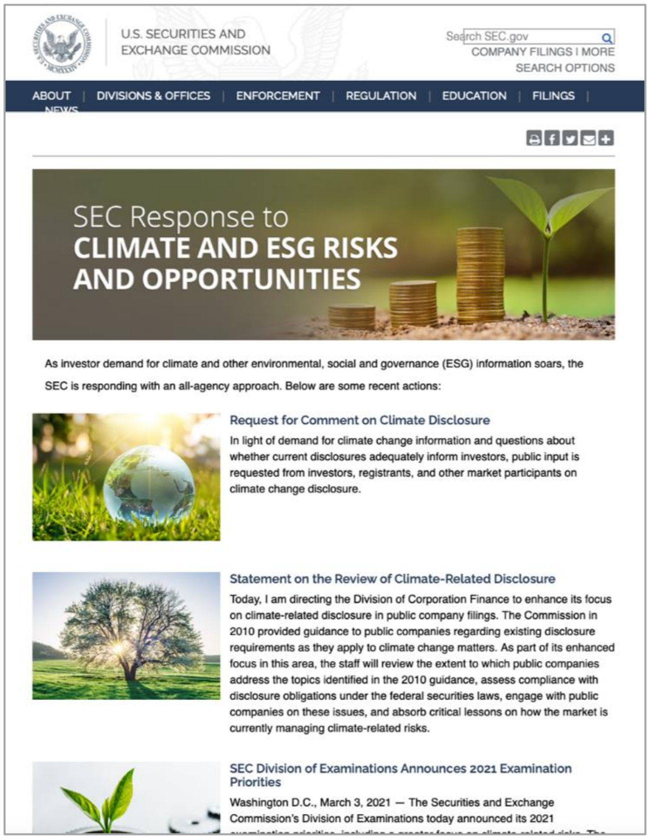
SEC response to climate change

As part of this initiative, the SEC has opened a webpage on its website to outline its response to climate change and ESG risks and opportunities. The webpage will be the landing page for SEC initiatives, proposals, and other climate-change information. This step indicates that the SEC is actively responding to investor's requests for ESG information and aligning its activities with the President's agenda.

Review and enforcement of disclosure requirements

The SEC has established a Climate and ESG Task Force in its Division of Enforcement to identify ESG-related misconduct proactively. The task force plans to use data analytics to mine for and access registrants' information for potential disclosure violations. The task force's initial focus will be to identify material gaps or misstatements in disclosures about climate risks as required under existing rules.

Also, the Acting Chair of the SEC, Allison Herren Lee, has directed the Division of Corporate Finance to enhance their review of disclosures on climate change matters to assess whether public companies are following the *Commission Guidance Regarding Disclosure Related to Climate Change* (Release Nos. 33-9106 and 34-61469) issued in 2010 and complying with disclosure obligations under SEC laws. The Division is expected to engage public companies on these issues and use the insights to update the 2010 guidance.



The 2010 guidance outlined specific existing rules that might require disclosures of climate-related matters:

- Description of a business,
- Legal proceedings,
- Risk factors, and
- Management's discussion and analysis.

The guidance also indicates that foreign private issuers using Form 20-F would be required to provide climate disclosures when discussing material risks, material effects of government regulations, environmental issues affecting utilization of assets, legal and arbitration proceedings, and factors that affect the financial condition and financial performance of the issuer.

Topics outlined in the 2010 guidance that might trigger disclosures under SEC requirements include:

- The impact of existing and pending legislation and regulations, including estimated capital expenditures for environmental control assets, risk factors, and the potential financial impact. Other impacts affecting the financial condition and financial performance warranting discussion in the MD&A are the effects of "cap and trade" systems, costs to improve equipment to reduce emissions or mitigate consequences of "cap and trade", and changes in costs resulting from new legislation and regulations.
- The impact of international treaties or accords on climate change. These disclosures would be similar to those required under legislation and regulations about climate change.
- Legal, technological, political, and scientific developments may create demand for new products and services or decrease demand for existing products and services. These trends and risks may need to be disclosed in the MD&A, and other developments may need to be described in the description of the business.
- The physical impact of climate change, such as severe weather events, rising sea levels, impact of droughts, and clean water availability, may affect operations and financial results.

The SEC is also asking for public input to help update the guidance on climate-related disclosures to generate consistent, comparable, and reliable information about climate change. The SEC is seeking input by posing several questions on the extent of disclosure regulation required, what types of reliable information and metrics about the effects of climate change are available, who should set standards for the disclosures, how to keep disclosure requirements up-to-date, how to mandate the disclosures, and how to monitor and enforce disclosures. These questions are in the Public Statement issued by the SEC Acting Chair on March 15, 2021.

Restrictions on issuers not complying with PCAOB auditor inspections programs

The Holding Foreign Companies Accountable Act (HFCA Act) became law in the US on December 18, 2020. The HFCA Act, which amended sections of the Sarbanes-Oxley Act of 2002, requires the SEC to identify each "covered issuer" that has retained a registered public accounting firm to issue an audit report where that firm has a branch or office located in a foreign jurisdiction, and the PCAOB has determined that it is unable to inspect or investigate completely because of a position taken by an authority in the foreign jurisdiction (non-inspected auditor).

The SEC has issued interim final amendments applicable to registrants filing annual reports on Forms 10-K, 20-F, 40-F, and N-CSR with an audit report issued by a non-inspected auditor. These registrants are required to submit documentation to the SEC on or before their annual report due date that establishes that they are not owned or controlled by a governmental entity in that foreign jurisdiction. The interim final amendments implement a process for this documentation requirement. If these registrants continue to submit audit reports issued by a non-inspected auditor for three consecutive years, the HFCA Act directs the SEC to prohibit the trading of the registrant's securities. The SEC staff is assessing how best to implement this requirement.

The HFCA Act also imposed additional disclosure requirements on these registrants, that are foreign issuers, as follows:

- Identification of the registered public accounting firm that has prepared an audit report for the issuer;
- The percentage of the shares of the issuer owned by governmental entities in the foreign jurisdiction in which the issuer is incorporated or otherwise organized;
- Whether governmental entities in the applicable foreign jurisdiction of the registered public accounting firm have a controlling financial interest in the issuer;
- The name of each official of the Chinese Communist Party who is a member of the board of directors of the issuer or the operating entity of the issuer; and
- Whether the articles of incorporation of the issuer (or equivalent organizing document) contains any charter of the Chinese Communist Party, including the text of any such charter.

The interim final amendments update relevant forms to require these disclosure requirements.

The SEC is requesting public comment regarding the implementation of the HFCA Act submission and disclosure requirements and the appropriate mechanics for determining the applicable issuers. These rules will apply to a registrant once the SEC has identified it as having a non-inspection year under a process. Once identified, a registrant will be required to comply with the amendments in its annual report for each fiscal year in which it is identified. The SEC plans to separately address the implementation of the trading prohibitions in the HFCA Act in a future notice and comment process.

Auditing update

Common fraud schemes

In January 2021, the Anti-fraud Collaboration (AFC) released a report covering common fraud schemes identified by the SEC enforcement activities from 2014 to 2019. The AFC was formed in 2010 by the Center for Audit Quality, Financial Executives Institute, The Institute of Internal Auditors, and the National Association of Corporate Directors. The report, *Mitigating the Risk of Common Fraud Schemes*, is based on a comprehensive review of some 204 SEC Accounting and Auditing Enforcement Releases by Latham & Watkins and AlixPartners.

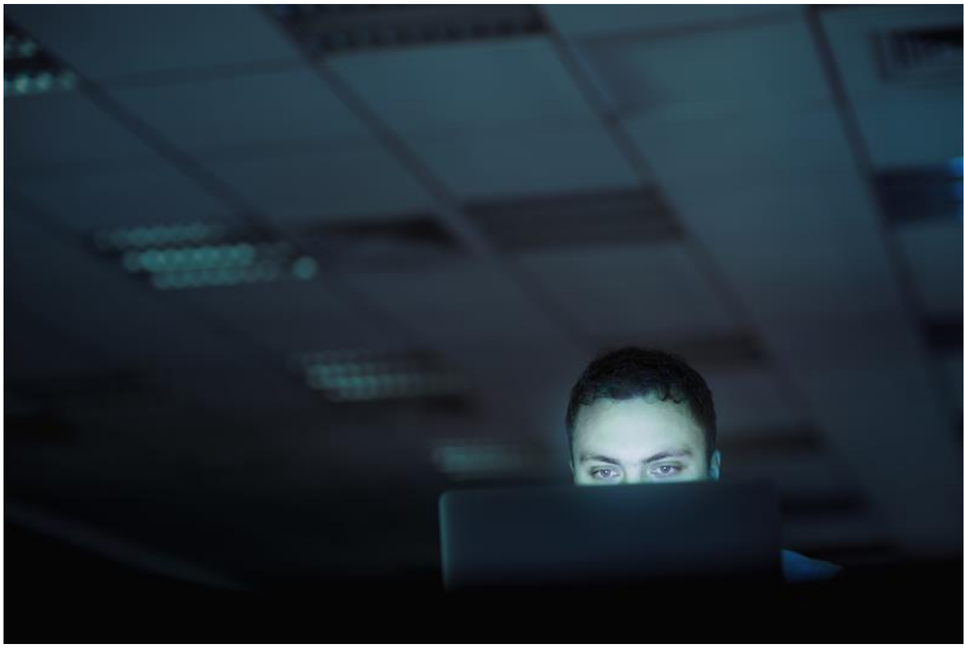
Potential for fraud risk increased with COVID-19

Using data from the 2008 financial crisis and recession, the AFC believes the COVID-19 environment may reveal similar fraudulent activity affecting revenues, credit losses, compliance with debt agreements, valuation of inventories, the improper capitalization of costs, use of big-bath write-offs, cookie jar reserves, and other schemes to meet projections, analysts estimates, and meet incentive plans. The economic challenges of COVID-19 have been compounded by the challenges of operating in a virtual world. Cybersecurity is another factor that increases fraud risk. From March to September 2020, the SEC has received 16,000 tips, complaints, and referrals, and 150 COVID-19 related inquiries and investigations have been opened.

Common areas for fraud

The study found the most common fraud schemes related to:

- Revenue – 60 instances involving improper revenue recognition associated with the timing of recognition, valuation of revenues, fictitious revenues, and the percentage of completion methods.
- Reserves – 34 instances involving the manipulation and improper reduction of reserves, the timing of reserves and recording of expenses, manipulation or misclassification of expenses, improper calculation of rebate and expense accruals, and failure to recognize liabilities.
- Inventories – 15 instances involving misstatement of cost of sales and overstating inventories.



- Impairment of assets – 15 instances involving the timing of impairments, deferral of credit losses, failure to record asset impairments, faulty valuations, and manipulation of reserves.

The report provides a detailed review of the various schemes and illustrations of cases and how the fraud affected financial reporting.

The outcome of these fraud schemes included 78 instances of false or misleading financial statements, 44 cases of material weaknesses in internal controls, and 11 instances of unsupported journal entries. The report indicated disclosures in the financial statements or MD&A often signal the presence of fraud, mainly when the disclosures are inconsistent with the financial performance or do not support the circumstances. Fraud often involves one or more players circumventing the internal controls. Common examples of internal control weaknesses contributing to fraud were inadequate segregation of duties, insufficient training of accounting staff, and failure to complete reconciliation of accounting balances.

Contributing causes and factors

The study identifies some root causes and factors that contributed to the frauds. Some of the facts and circumstances that contributed to the frauds identified by the SEC were:

- Tone at the top – if senior management is unconcerned about ethics and focuses solely on the bottom line, employees may be more prone to commit fraud. There may be attitudes towards cutting corners, ignoring internal controls, violating laws and regulations, focusing on revenues and profits at all cost, setting compensation based on unrealistic targets and metrics, creating workplaces that do not reward employees on merit, accepting abusive and discriminatory behaviours, retaliating against whistle-blowers, and failing to articulate and support codes of conduct or ethical standards.
- High-pressure environment – pressures to achieve unrealistic goals may lead to employees circumventing standards or procedures for fear of losing their jobs, not earning incentive pay, or having to face other harsh reprisals. Transparent reporting of targets and achievements, training in the company's standards and expectations, setting realistic targets and deadlines, and addressing bad news with positive steps can help reduce the risk of fraud perpetrated by employees.
- Lack of personnel with sufficient accounting experience or training – some employees without adequate experience or training may be susceptible to accept excuses or rationalization from those attempting to commit the fraud. Inexperienced staff may not recognize inadequate supporting documentation, noncompliance with company policies or current accounting standards, or irregularities in journal entries. Companies should ensure employees update their skill sets regularly and ensure employees are kept apprised of current best practices, new guidance, and emerging risks.

SEC actions against frauds

The SEC takes enforcement actions against the issuers and executives, and employees of the issuers involved in the frauds. During the study period, actions were taken against 90 issuers, 44 CEOs, 76 CFOs, 21 controllers, and 69 other employees in the accounting and sales departments. Individual accountability is a key pillar of the SEC's enforcement program.

Actions by industry sector were predominantly in technology services (24), finance (18), energy (16), manufacturing (12), and healthcare (8). About 61% of the issuers with fraudulent activities were small-cap companies (market capitalization less than US$2 billion), 11% were mid-cap (US$2 billion to US$10 billion), and 11% large-cap (> US$10 billion). Many smaller cap companies have a higher risk of material weaknesses of internal control over financial reporting, which is consistent with an Audit Analytics study which found 39% of nonaccelerated US filers (market cap less than US$75 million) reported material weaknesses in ICFR in 2019. The Audit Analytics study found material weaknesses reported related to accounting staff's competency and training, lack of segregation of duties, and internal controls design. Similarly, Audit Analytics reported that 61% of total restatements of financial statements were made by nonaccelerated filers.

Some take-aways

The study found that the impetus for fraud was often to meet analyst's expectations or year-end financial metrics. Further, employees involved in fraud tended to hide their conduct. The AFC outlined some qualitative factors companies can consider to identify yellow and red flags early and mitigate fraud risks.

The AFC notes that understanding the company's culture is important to manage, preserve, and enhance it. Cultural objectives should be communicated, monitored, and reinforced. Culture can be an effective stop-gap when circumstances occur, not covered in a company's policies and procedures. A positive ethical culture may mitigate fraud risk and deter misconduct.

Skepticism can be a valuable tool in detecting fraud. While auditors are required to be skeptical, employees should also adopt an independent mindset. Fraud risks may be mitigated by employees double-checking and challenging information, even if received from a supervisor, senior management, or a reliable source. Further, employees must be willing to acknowledge their biases and challenge their assumptions and conclusions to assess when verifying their work.

Fraudulent activities often involve executives of a company. Executive management and the board play an essential role in assessing management's integrity. This oversight might include asking the right questions, assessing identified risks, monitoring and guiding the corporate culture, and identifying and following-up on red flags (such as high employee turnover in certain areas, whistle-blowers or hotline complaints, employee social media complaints, complaints from vendors, suppliers, and others, and compensation practices that could lead to inappropriate behaviours).

Comprehensive risk assessment involves understanding the business, its processes for defining, identifying, assessing, and monitoring risks. Data analytics help determine fraud risks by identifying red flags and high-risk areas, validating the risk assessment findings, and monitoring high-risk areas. For data analytics to be effective in early fraud detection, the analysis used must be well defined, and data security and integrity are essential. Data mining of specific accounting records or geographic locations susceptible to fraud can facilitate a robust fraud risk assessment.

The AFC study provides many valuable insights on fraud risk and developing effective oversight to mitigate the risks. The report is a must-read for management and board members interested in understanding the types of frauds that can occur and developing fraud risk management programs.

Anti-money laundering

The International Federation of Accountants and the Institute of Chartered Accountants in England and Wales have sponsored six publications to help accountants titled *Anti-Money Laundering: The Basics.* The series is intended to enhance accountants' understanding of how money laundering works, the risks they face, and what they can do to mitigate these risks and make a positive contribution to the public interest. Instalments three to six were released from November 2020 through to March 2021. The complete series is available on the IFAC website.

Each of the instalments reviews the possible exposure for professionals providing services, an approach to assessing the risk that the activities involve suspicious behaviours, some red flags to be aware of, and actions to take when the actual or potential activities are suspicious. While some of the guidance is oriented to accountants in the UK, the guidance can be applied by any professionals that may be involved with structuring legal organizations and transactions and providing tax advice.

Instalment one, *Introduction to Anti-Money Laundering for Professional Accountants,* and instalment two, *A Risk-Based Approach,* were covered in previous editions of *AC Insights.*

The third instalment, *Company Formation,* examines how criminals use company formation services to assist in money laundering. In many countries, professional accountants provide company formation services exposing those accountants to this risk. The use of corporations can provide anonymity to criminals, and shelf companies' use can give the appearance of corporate history.

Instalment four, *Asset Transfers,* looks at how criminals use asset transfers, such as transfers of real estate and high-value assets, to launder money. Accountants may be asked to assist in moving assets or providing tax advice on structuring transactions.

Accountants often provide tax advice to minimize taxes. Criminals may use an accountant's services to structure transactions or entities to mitigate tax through moving assets or cash and to evade taxes. Accountants may also be involved in compliance activities such as preparing tax returns. The fifth instalment, *Tax Advice,* looks at the risks of providing these services without a risk-based approach and adequate due diligence.

Instalment six, *Businesses in Difficulty,* addresses situations where businesses in financial trouble can be exploited by or become the targets of criminals. Criminals could persuade business owners to allow an investment using the proceeds of crime and later receive payments from the business, which appears legitimate. Further, the business may be used to conduct fraudulent activities.

The series provides some helpful insights for accountants and boards into possible risks, including red flags, that some participants in arrangements or transactions may not be who they appear to be.

CPAB finds deficiencies in audits of cannabis companies

In 2019 and 2020, the CPAB inspected the audit files of 42 cannabis issuers and found significant issues in 22 of these files. The findings were reported in the *CPAB Exchange: Auditing in the cannabis sector*, issued in February 2021. The *CPAB Exchange* indicated that improvements were necessary "to improve audit quality and to protect capital markets".

The report provides some interesting insights into a new industry. The industry has some unique attributes and operating procedures. These challenges affect the issuers' accounting and internal controls over financial reporting and the auditors' approaches to the audits.

The four most common deficiencies were outlined and explained as follows:

1. Insufficient understanding of the entity and its environment related to laws and regulations affecting the industry. Noncompliance with laws, regulations, and licenses could significantly impact the issuer and its financial statements. Some areas of concern were lack of reconciliation of grow areas and inventory to licenses and movement of inventories and their impact on verifying inventory quantities. CPAB note that companies in the industry have complex organizational structures, lack of internal controls, and limited access to banking services, which raise the fraud risk. Auditors may need to put more effort into assessing fraud risks for these factors.

2. Inadequate fraud risk assessment and audit response in companies operating in foreign jurisdictions where banking services are limited. In certain countries, cannabis companies cannot access banking services, and a significant portion of the transactions are in cash. The CPAB noted concerns over the auditors' work performed to assess the occurrence and completeness of revenue, including the evaluation of the design and implementation of internal controls over the cash cycle, the failure to obtain evidence of deliveries for cannabis sales to valid customers, and inadequate procedures to support the validity of cash disbursements and transfers.

3. Lack of evidence to support key inputs used in the fair value of biological assets. Under IFRSs, cannabis plants, until harvested, are considered biological assets measured at fair value. CPAB found some auditors did not obtain sufficient evidence to support key inputs used in the valuation models, notably the inputs for yields, lifecycles, and selling prices. Auditors sometimes relied on internal and external information to support yield and lifecycle estimates without performing adequate procedures to support whether that information was relevant to the particular strain, consistent with the company's actual yields, and consistent with its grow processes. Further, selling prices used in models were based on historical prices and wholesale contract prices with limited comparison to published prices from regulatory agencies.

4. Inadequate procedures to support biological assets and inventory quantities. Cannabis companies must track their inventories from seed to sale using information technology systems provided by government agencies. While these were government-supported applications, some auditors failed to consider access controls over these systems adequately and whether data could be modified by company personnel. Observing physical counts of cannabis plants and products can be challenging due to possible contamination and other restrictions. CPAB found limited auditors' observations of counts in drying rooms and inadequate procedures to reconcile quantities to manual logs or IT-generated reports.

CPAB encourages auditors, audit committees, and management of cannabis issuers to consider these findings and work together to implement changes to the audit approach.

PCAOB conversations with audit committee chairs

The PCAOB engages with the majority of the audit committees of public companies whose audit files are subject to inspection. In these discussions, the PCAOB focuses on auditor communications with audit committees, new auditing and accounting standards, and emerging technologies. The PCAOB also discussed the challenges for auditors, audit committees, and public companies arising from COVID-19.

The highlights of these discussions were summarized in the PCAOB *2020 Conservations with Audit Committee Chairs* issued in February 2021. Some key take-aways on audit communications with audit committees were:

- Both verbal and written communications were extremely important to audit quality and the committees' relationships with their auditors. Many chairs appreciated the auditors' dashboards to highlight real-time data on audit progress and other issues.
- Audit committee chairs observed that audit firms performed well in bringing in expertise for complex accounting issues, consulting with their subject matter specialists, offering practical approaches to problem-solving, and having engagement team continuity.
- Some areas for improvement noted were partner rotation, use of innovation, managing global audits, helping junior staff learn the company's business, communications of independence matters, auditing controls of outsourced service partners, over-auditing or over-documentation, and discussions about audit fee changes.
- Audit committee chairs who reviewed their auditor's inspection reports generally found the information helpful but were concerned about the lag between the date of the inspections and the date the reports were released.
- Audit committee chairs noted audit firms had taken several initiatives to prevent audit deficiencies, including the use of emerging technologies, setting an appropriate tone at the top of the audit firm, robust training, and focus on new auditing and accounting standards.
- Audit committees assess the auditor's performance at various times, annually, quarterly, and real-time, emphasizing the lead engagement leader's performance and the auditor's communications and timeliness.

The last inspection cycle considered the challenges of new accounting standards for revenues, leases, and credit losses and new auditing standards for reporting critical audit matters. Audit committee chairs thought the implementation of CAMs' reporting was smooth because of the auditors' early preparation, including dry runs. However, the PCAOB discovered that the majority of the audit committee chairs were not aware of the new auditing standard for auditing accounting estimates, which was effective for fiscal years ending on or after December 15, 2020.

Many audit committee chairs saw the use of emerging technologies in audits as a way to improve the audit and the quality of financial reporting. Data analytics, workflow automation, cloud computing, and other tools were noted as beneficial to reducing manual work, improving the quality of evidence, and being more efficient. The other benefits of the use of technology noted were the reduction of fraudulent reporting and unusual anomalies. However, with benefits, there were concerns over the gap between the audit firm's technologies capabilities and the companies; risk of cybersecurity events; and the over-reliance on technology leading to less use of professional judgment, experience, and skepticism. The chairs emphasized the need for both companies and auditors to develop training for new technologies, adjust controls over the use of technologies, and understand the potential risks of using new technologies.

These insights from audit committee chairs provide some matters for Canadian audit committees to think about when reviewing audit plans, assessing auditor performance, and considering how their companies and auditors use technology.

An external auditor assessment tool

The Center for Audit Quality (US) has updated its guide, *External Auditor Assessment Tool*, for audit committees to assess auditors. The Tool was originally published in 2019. In the revisions, the CAQ updated the references to resources and emerging risks. No changes were made to the questions and sample form included in the 2019 Tool.

The Tool outlines an assessment process and provides guidance and questions for the evaluation of four key areas:

- The quality of services and sufficiency of resources at the engagement team level, including their skill and responsiveness, hours and workload, audit plan and risks, participation of engagement partner and other accounting firms, partner rotation, resources brought in on complex accounting and audit matters, and management of hours and costs.
- The quality of services and sufficiency of resources at the audit firm level, including network resources, the firm audit quality report, the tone at the top, resource allocations for engagement teams, policies for planning and performing quality audits, and policies and procedures to monitor quality.
- Communication and interaction among management, the audit committee, and the external auditor covering the openness of communications, nature of communications, and how sensitive issues are communicated.
- Auditor independence, objectivity, and professional skepticism, including compliance with independence requirements, discussions of disagreements with management, promotion of professional skepticism, reliance on internal audit, and pre-approvals for non-audit services.

The Tool also provides a management feedback form on which management can rate the auditor's performance on several attributes consistent with the audit committee evaluation framework.

The Tool also summarizes the relevant rules and standards for auditors contained in SEC rules, PCAOB standards, and the New York Stock Exchange rules. A reading list is provided referencing guidance from accounting and legal firms, Chartered Professional Accountants of Canada, and the Center for Audit Quality.

Corporate reporting update

Sustainability reporting moves forward

IFRS Foundation to organize standards board

The Trustees of the IFRS Foundation decided in March 2021 to continue working to establish an international sustainability reporting standards board under the IFRS Foundation's governance. This decision was based on feedback received that there is an urgent need for such standards. This decision was welcomed by the International Federation of Accountants (IFAC) and the International Organization of Securities Commissions (IOSCO). IOSCO stated that it "sees an urgent need to improve the consistency, comparability, and reliability of sustainability reporting, with an initial focus on climate change-related risks and opportunities, which would subsequently be broadened to other sustainability issues". IOSCO plans to work with the IFRS Foundation in establishing a sustainability standards board with a strong governance structure.

The IFRS Foundation strategy for the new board includes:

- **Investor focus for enterprise value:** focusing on information that is material to the decisions of investors, lenders, and other creditors.
- **Sustainability scope, prioritizing climate:** focusing initially on climate-related reporting while also working towards meeting the information needs of investors on other ESG (environmental, social, and governance) matters.
- **Build on existing frameworks:** building on the work of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) as well as work done by other organizations with similar interests.
- **Building blocks approach:** providing a globally consistent and comparable sustainability reporting baseline, with the flexibility expanding to include broader sustainability impacts.

The IFRS Foundation Trustees plan to make a final determination about a new board in advance of the November 2021 United Nations COP26 conference.

During the quarter, the International Integrated Reporting Council (IIRC) endorsed the statement by IOSCO supporting the development of an international sustainability standards board along with the IFRS Foundation.

Moves to enhance credibility of sustainability reports

Investors continue to want credible standardized ESG information to support their long-term assessment of their investments. The Center for Audit Quality believes auditors can play a role in enhancing the reliability of ESG information provided to investors.

In a follow-up to the Center for Audit Quality's 2020 paper, *The Role of Auditors in Company-Prepared ESG Information: Present and Future,* the CAQ issued a paper that provides more detail on the range of assurance services that auditors could provide to enhance confidence in ESG information and matters for boards of companies to consider. This additional guidance was published in March 2021 in the paper, *The Role of Auditors in Company-Prepared ESG Information: A Deeper Dive on Assurance*.

While the auditor under PCAOB standards only needs to read information accompanying the financial statements, the paper outlines that a company may want third-party assurance on ESG information to assess whether the information made publicly available is of high quality and reliable, to enhance the board's and management's confidence in the integrity of the information, add credibility to information provided to third party customers and suppliers, and improve ratings and rankings in sustainability indices. The paper explains that external auditors are well suited to providing assurance on ESG information because auditors are required to be independent; understand the company, its operations, processes, and strategies to create value; have access to specialist in most ESG areas; have expertise in planning and performing assurance engagements; have experience in reporting on compliance in different frameworks; have systems of quality control in place; and are required to adhere to professional standards on competency, ethics, and training.

The paper notes that metrics and quantitative information reported following sustainability standards are within the scopes of assurance standards, while certain qualitative statements that cannot be measured or evaluated against criteria may not be within the scope of assurance standards. Depending on the circumstances, the ESG information could be audited or reviewed. Another form of comfort would be a readiness assessment, which provides an independent view of the frameworks, reporting processes, internal controls, the evidence available, and governance processes for ESG information.

If the board of directors is considering an assurance engagement to maintain good governance policies and controls over ESG information, the paper provides some critical questions the board members may ask management and the auditors.

<IR> framework updated

During the quarter, there have been some significant developments to integrated reporting. The International Integrated Reporting Council (IIRC) defines an integrated report as "a concise communication about how an organization's strategy, governance, performance, and prospects, in the context of its external environment, lead to the creation, preservation, or erosion of value over the short, medium, and long term". Some international companies preparing integrated reports are ArcelorMittal, BASF, Honda Motor, HSBC Holdings, National Bank of Australia, Novo Nordisk, Sanofi, Standard Bank, Tata Steel, Unilever, and Vancity Savings Credit Union.

These integrated reports are prepared using the Integrated Reporting (<IR>) Framework, first published by the IIRC in 2013. In January 2021, the IIRC published an update to the Framework to enable more decision-useful reporting. The revisions simplify the requirement for a statement of responsibility for an integrated report, improve the underlying reporting process, clearly distinguishes between outputs and outcomes, and emphasizes balanced reporting of outcomes and value preservation and erosion scenarios. The revised framework is contained in the IIRC document, International <IR> Framework, January 2021.

During the quarter, the IIRC endorsed the statement by IOSCO supporting the development of an international sustainability standards board along with the IFRS Foundation. The IIRC also plans to merge with the Sustainability Accounting Standards Board into the Value Reporting Foundation. The two organizations see the IIRC through its <IR> Framework, providing the "how" to report while the SASB, through its standards, providing the "what" to report. The SASB has developed a complete set of standards for 77 industries identifying the minimal set of financially material sustainability topics and their associated metrics.

In conjunction with the new Framework's release, the IIRC and IFAC noted that the demand for assurance services on such <IR> reports is expected to rise accordingly. The two bodies are launching a new joint initiative, Accelerating Integrated Reporting Assurance in the Public Interest ('the initiative'), to explore integrated report assurance and how to best deliver it in the broad and forward-looking focus on value creation. The first step of the initiative is to address the difference between the two types of assurance – limited and reasonable – and what is required of auditors and organizations to strive for reasonable integrated reporting assurance. To help understand this first step, IFAC and IIRC published a paper, *Accelerating Integrated Reporting Assurance in the Public Interest*.

.