

Enhanced auditor's report

Observations on
Key Audit Matters (KAMs)
and Critical Audit Matters
(CAMs) in Canada

June 2021

Foreword

Message from PwC Canada Assurance Leader

A number of steps were taken in the aftermath of the 2008 global financial crisis, in Canada, the United States and internationally, for auditors to provide more information to stakeholders. Audit reports had remained relatively unchanged for decades and were seen as boilerplate statements, providing little insight about the audit process. As a result, a revision of auditor reporting standards was made to enhance the auditor's report around the globe.

The introduction in Canada of Key Audit Matters (KAMs) over the past year, and Critical Audit Matters (CAMs) over the past two years in the US, is an important milestone in this journey and we are taking the opportunity to reflect and share our observations to date in this report.

This report is designed to help you in continuing your discussions with your auditors with regards to auditor reporting in Canada.



Michael Paterson
PwC Canada
Assurance Leader



Introduction

This report presents our observations on the implementation of Key Audit Matters (KAMs) and Critical Audit Matters (CAMs) (together, referred to hereafter as “audit matters”) with respect to TSX-listed companies. Our observations relate to the number and nature of audit matters and, where relevant, were further disaggregated into industries, market capitalization and audit firms.

We also used observations included in the publication “Serving Their Purpose? Insights on Critical and Key Audit Matters,” published by Audit Analytics and issued in February 2021 (referred to hereafter as “Audit Analytics publication”), which relates to 2019 auditor’s reports issued in the US, UK and Europe, as a basis of comparison and contrast for some of our observations.

Background of the new and revised auditor reporting standards in Canada

The Independent Auditor’s Reports for most Canadian-listed companies on the TSX now contain KAMs effective for years ended on or after December 15, 2020. KAMs are expected to provide enhanced disclosure about the areas that are of most significance to the audit.

The US has also implemented a similar reporting reform through the introduction of CAMs. This started with large accelerated filers for the year ended on or after June 30, 2019 and for all other companies (aside from specific exceptions) for years ended on or after December 15, 2020.

While the objectives of the KAMs and CAMs to be more transparent about the audit are similar, the definition of the KAMs and CAMs in their respective auditing standards¹ are different.

Since the population of our report includes many companies that are listed both in Canada and the US, and the fact that CAMs were implemented earlier in the US, our report also looks at the impact these may have had on the implementation of KAMs in Canada.



¹ CAMs are required by auditing standards issued by the Public Company Accountability and Oversight Board (PCAOB) while KAMs are required by the Canadian Auditing Standards (CAS).

Population

This report took into account the audit reports issued for the top 300 companies listed on the TSX (based on market capitalization) for years ended on or after December 15, 2020, which are required to include audit matters in their audit reports.² These companies are from 12 different industries (see page 7).

The population included 119 companies subject to PCAOB auditing standards (dual-listed) and 181 companies subject to CAS or International Standards of Auditing (ISA). The population also includes five companies that reported under both standards (PCAOB and CAS) and therefore issued KAMs and CAMs. The KAMs and CAMs were the same in both reports and, for the purpose of this report, the matters have been included once and classified under the CAM category.

In total, the observed companies generated 479 KAMs and CAMs.

Lastly, the population of audit reports for these companies were provided by eight audit firms.

For more information on the population, refer to Appendix A.



300

Listed companies
on the TSX



8

Audit firms



119

Dual-listed companies
as SEC registrants



12

Industries



479

Number of KAMs
and CAMs

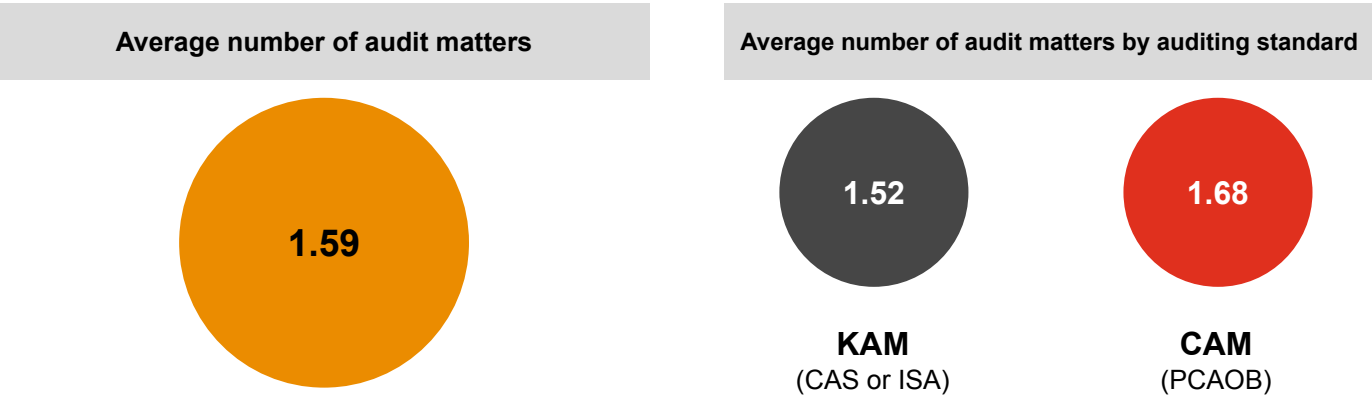
² Key audit matters (KAMs) are applicable for all audits of complete sets of general purpose financial statements of companies listed on the Toronto Stock Exchange (TSX), **excluding** listed companies required to comply with National Instrument 81-106, Investment Fund Continuous Disclosure (such as investment funds), for periods ended on or after December 15, 2020. For periods ending on or after December 15, 2022, other listed companies (such as those listed on venture exchanges), excluding listed companies required to comply with National Instrument 81-106, are required to include KAMs in their audit reports.

Communication of Critical Audit Matters (CAMs) is not required for audits of companies that are: (1) brokers and dealers reporting under Exchange Act Rule 17a-5; (2) investment companies registered under the Investment Company Act of 1940, other than companies that have elected to be regulated as business development companies; (3) employee stock purchase, savings, and similar plans; and (4) emerging growth companies (EGC).

Observations

Average number of audit matters

The average number of audit matters raised in an audit report for the observed population is 1.59. Breaking this down into KAMs and CAMs, the average number of audit matters did not vary significantly.



We noted that while the average number of audit matters (1.59) in our population was comparable to the average number of 1.6 for US companies per the Audit Analytics publication, it was significantly lower than those reported in the same publication for the UK and EU (2.8 and 2.4, respectively). These observations may indicate that the implementation of CAMs may have had an influence on the implementation of KAMs in Canada, including the number of audit matters identified.

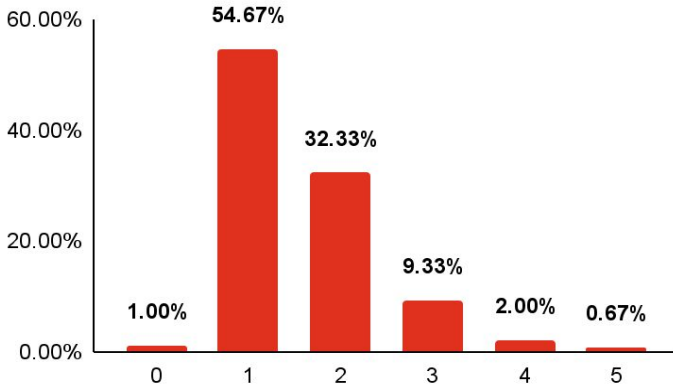
Observations from Critical Audit Matters in 2019

From the population of audit reports observed in this report, we selected about 20 companies that had CAMs in 2019 (large accelerated filers) and compared their 2019 and 2020 audit reports. Our observation noted that the average number of CAMs did not change significantly year over year. From this same selection, we also noted that the topics of the CAMs did not typically change, although, in some instances, we noted that the scope of the CAM may have been greater in the current year (e.g. more cash-generating units included in the impairment assessment). In the limited case where there was a new CAM or a CAM was removed, they were usually related to a one-time transaction during the year.



Observations

Distribution of the total number of audit matters



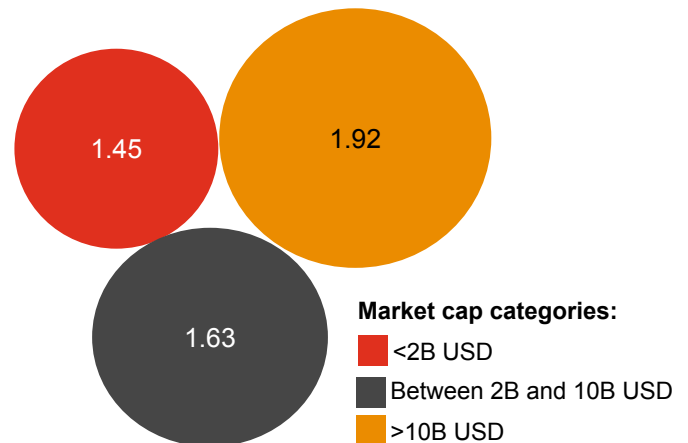
Number of audit matters distribution

A majority of the observed population had one audit matter. This distribution is consistent with similar US companies, but lower than the UK and EU as noted in the Audit Analytics publication. The distribution shows that audit reports with no audit matters are relatively rare. Only three companies out of our population of 300 companies had no audit matters.

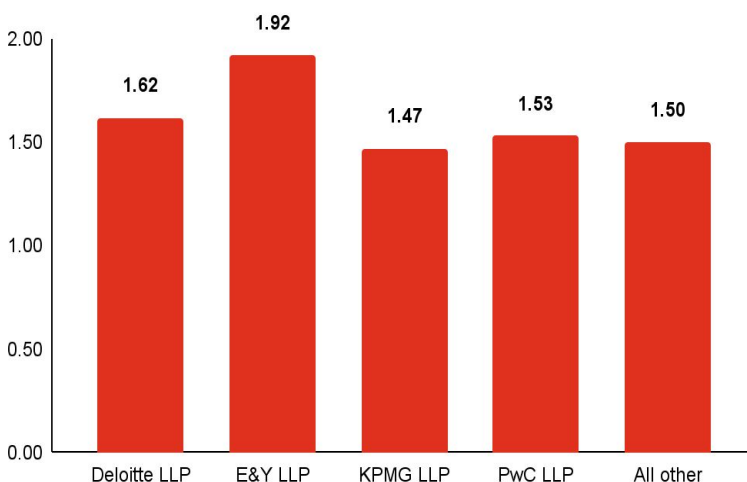
By market capitalization

We observed that the number of audit matters shows a slight increase as the market capitalization of the company increases. This is in line with the expectation that audits of companies with higher market capitalization usually result in a higher number of audit matters. This is due to many factors, which include: complicated business and operating structures, the types of transactions these companies enter into that may increase audit complexity, and effort.

Average number of audit matters by market capitalization



Average number of audit matters by audit firm



By audit firm

The average number of audit matters per engagement issued by each audit firm is very consistent among all firms. The results were not different when broken down between KAMs and CAMs.

Observations

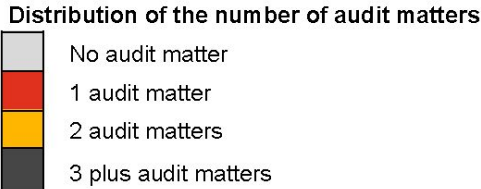
By industry

The number of audit matters raised varied by industry, with the financial services industry identifying the most number of audit matters on average.

Comparing this with other jurisdictions as noted in the Audit Analytics publication, the industries with the highest average number of audit matters were mining (US: 1.8, EU: 2.6) and retail (UK: 4.4).

Number of audit matters by industry

Industry (companies in industry)	Distribution of the number of audit matters			Average
Financial services (38)	24%	37%	39%	2.37
Life sciences (9)	33%	45%	22%	1.89
Clean technology (13)	39%	46%	15%	1.85
Oil and Gas (22)	41%	50%	9%	1.68
Comm and Media (7)	43%	57%		1.57
Consumer products and services (25)	56%	36%	8%	1.52
Mining (71)	4%	59%	14%	1.48
Utilities and Pipelines (13)	54%	46%		1.46
Industrial products and services (50)	66%	30%	4%	1.38
Technology (16)	63%	37%		1.38
Real estate (32)	78%	19%	3%	1.25
Closed-end funds (4)	100%			1.00



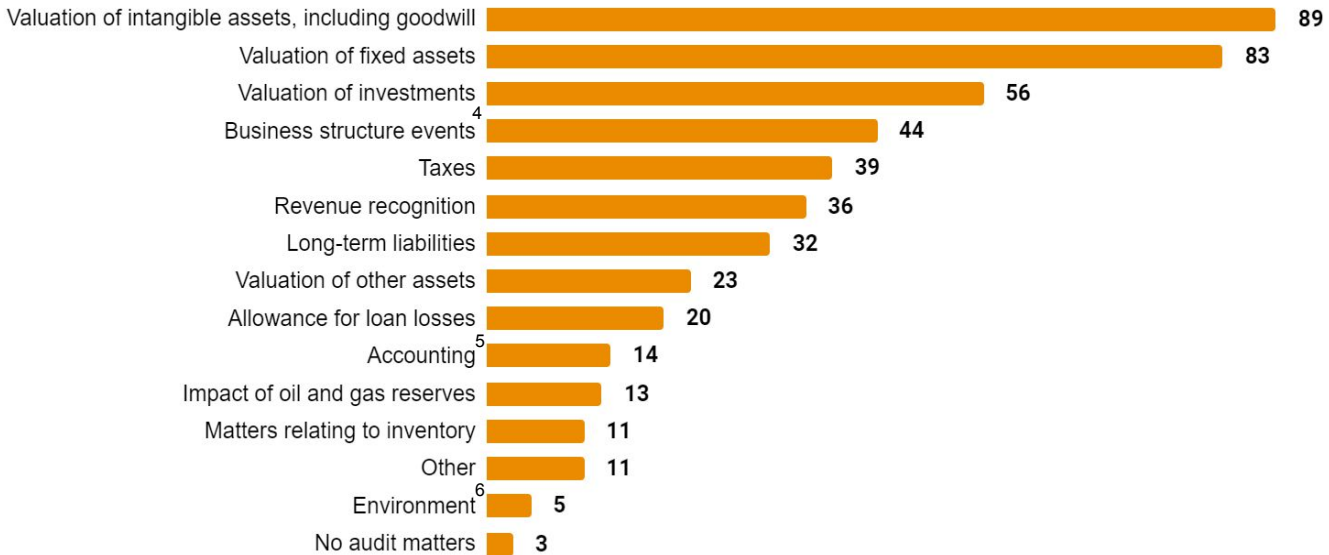
There is no expectation to the number of audit matters for a particular company as the determination of the audit matters should be based on the facts and circumstances of the client for that year. As indicated in the table above, the average number of audit matters for many of these industries are within a close range. We also observed that having no audit matters is rare.

Observations

By topic

The top three most identified audit matters are: **valuation of intangible assets (including goodwill)**, **valuation of fixed assets** and **valuation of investments**. This is not surprising as these are areas that typically involve significant management judgment and have the greatest effect on the audit strategy, resources and effort.

Number of audit matters by common topic – combined KAM and CAM



Comparing this to the observations in the Audit Analytics publication, we noted intangible assets was also the most common topic for the US and EU companies. For the UK companies, however, revenue recognition was the most common identified topic. This is a surprising contrast to our observations in Canada wherein revenue recognition did not appear in the top five most common topics.

However, the results of our observations in this report are dependent on the mix of companies within industries, industry-specific risks and, in some cases, the accounting framework that is being applied. For example, valuation of investments that showed up in the top three most identified audit matters was not consistent with the US, UK and EU, and is due to the fact that we have a large number of real estate companies in our population and that the accounting framework applied by these companies requires the investment property to be recorded at fair value.

⁴ **Business structure events** — Audit matters arising from accounting and valuation of business transactions including business combinations, disposals, joint ventures and discontinued operations.

⁵ **Accounting** — Audit matters arising from adoption or revision of an accounting principle.

⁶ **Environment** — Audit matters arising from the business environment of the company, such as the system of internal controls or the ability to continue as a going concern.

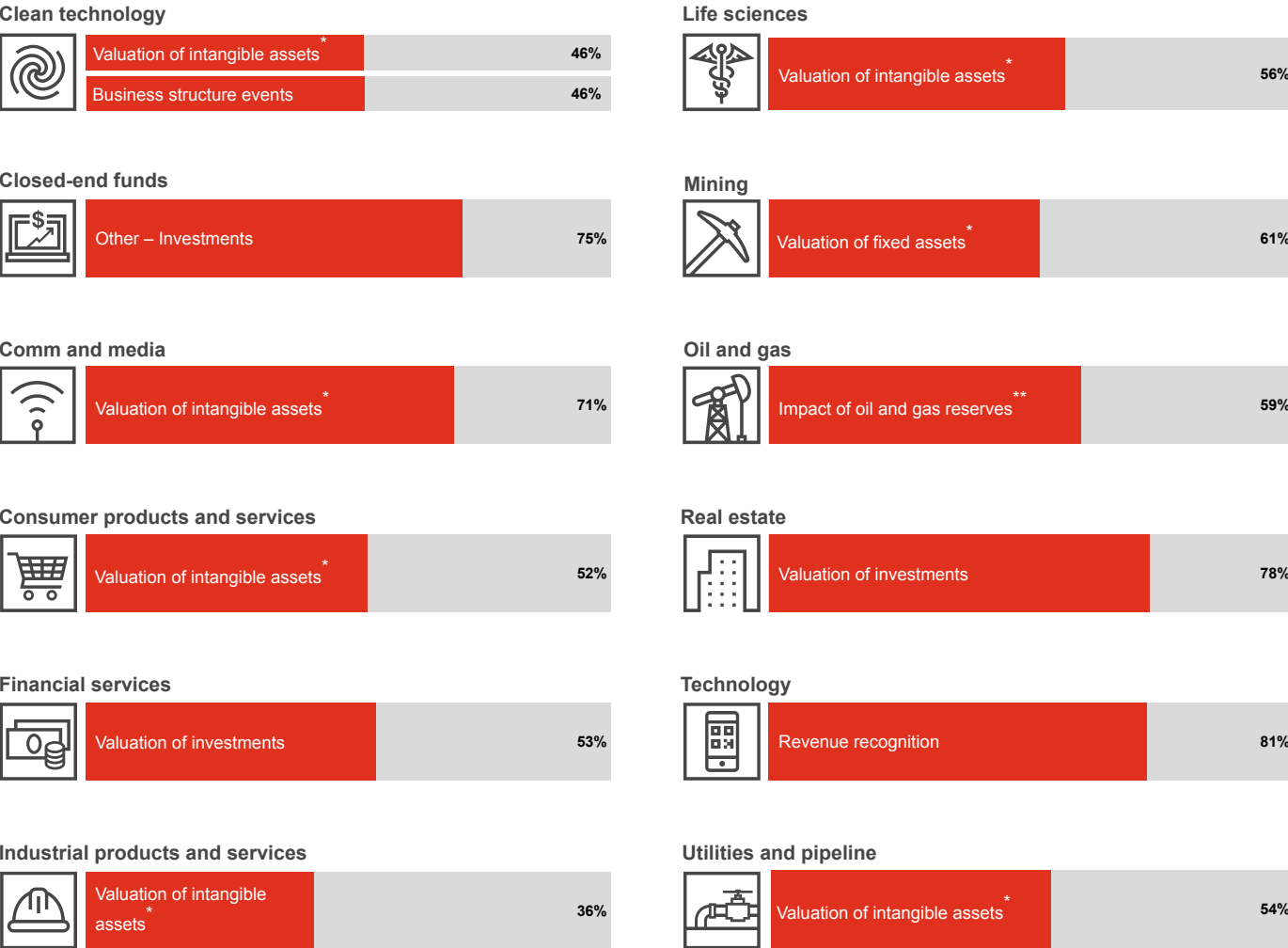
Observations

By industry

The table below shows the most identified audit matter topic (combined KAMs and CAMs) for the industries included in our population. This is expressed by the *percentage of audit reports* within each industry that reported that particular audit matter topic.

We also noted that when disaggregated between KAM and CAM, the most identified audit matters remained relatively consistent.

For a full list of audit matters identified for each industry and their related percentages (disaggregated between KAM and CAM), refer to **Appendix B**.



* We have made some judgment in the categorization of audit matters based on the titles and description made by the auditors. For example, when the title of the audit matter refers to the testing and valuation of assets within a cash generating unit which might have included goodwill, we have categorized them as "valuation of fixed assets".

** Similarly, if reference was made by the auditor to "oil and gas reserves" in the audit matter title, we categorized the audit matter as "impact of oil and gas reserves". However, it is possible that some audit matters related to valuation of fixed assets may also relate to the impact of oil and gas reserves when testing the valuation of the entire operating unit.

A continuous journey

The implementation of enhanced auditor reporting standards was designed to provide various stakeholders with more transparent and insightful information about the audit. Further, it was designed to also enhance the dialogue between auditors, management and audit committees. This dialogue has resulted in improvements to financial statement disclosures.

No post-implementation review has been conducted in Canada so far to assess how useful investors and other stakeholders find the information contained in the KAMs and CAMs—or if the nature of audit matters that the auditors have identified met their expectations.

However, if Canadian investors and stakeholders do not fully see the benefits in the reporting of audit matters, there is a risk that the new auditor's reports would just become longer with more boilerplate language over time. But there is an opportunity for auditors to make it more relevant by addressing emerging topics, such as the impact of climate change on the company's financial reporting and the audit.

The challenge ahead for auditors and their clients is to agree on a path forward that will allow the delivery of audit reports to the market that contain information that is transparent, useful and relevant. It is also important that companies continue to enhance financial statements and management discussion and analysis (MD&A) disclosures, and for the auditor to continue to embrace the spirit of the new reporting requirements.

As observed in this report, the implementation of KAMs in Canada has been influenced by the implementation of CAMs in the US. Reporting of KAMs or CAMs is still relatively new in Canada—and similar to the continuous developments we have seen in other parts of the globe, it is a journey.

We encourage all stakeholders of the audit to provide feedback on this new form of reporting for the continued evolution of auditor reporting in Canada and in North America.



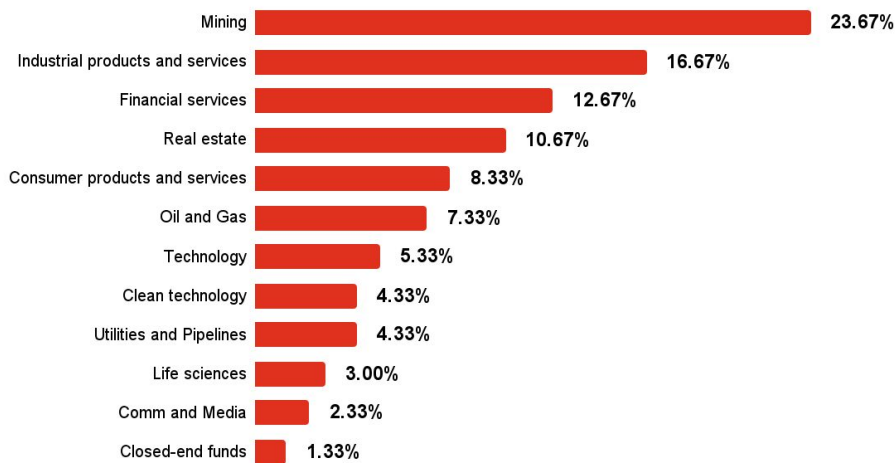
Appendix A — The population

The 479 audit matters shown by type.

Number of audit matters – KAM vs CAM



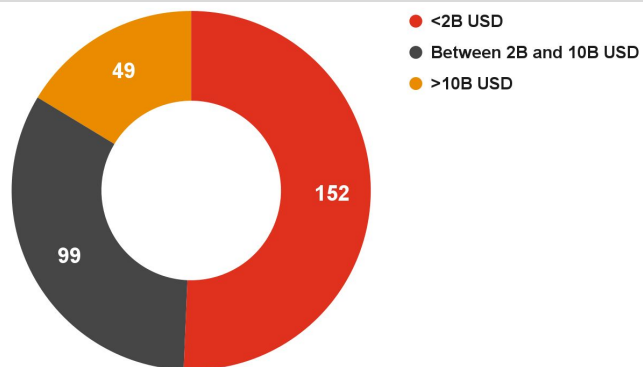
Distribution of the companies by industry



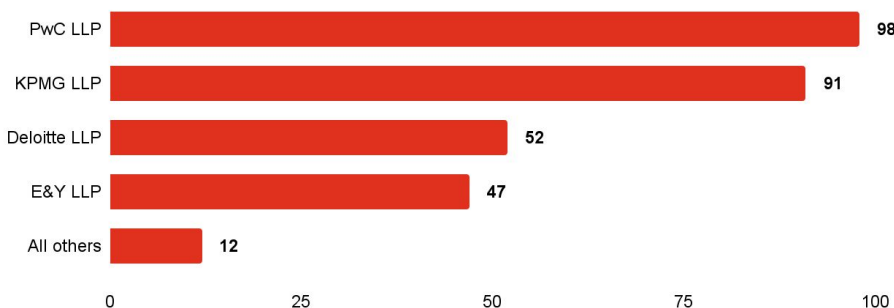
The composition of the 300 companies shown by their TSX industry categorization.

Number of companies by market capitalization size

The 300 companies shown using three market capitalization sizes.



Companies by audit firm



The number of companies shown by audit firm who issued the audit report.

Appendix B — Industry-specific observations

By industry

The tables below show the number of audit reports within each industry that contain each audit matter topic. The analysis has been disaggregated between those companies subject to KAM or CAM reporting.

Numbers in brackets are the total number of companies observed, both for the industry and broken down between KAM and CAM reporters.

	Audit matter topic	KAM	CAM	Combined
Clean technology (Number of audit reports: 13 - KAM: 6, CAM: 7)	Business structure events	3	3	6
	Valuation of intangible assets, including goodwill	3	2	5
	Valuation of fixed assets	2	4	6
	Valuation of investments	1	-	1
	Taxes	1	-	1
	Valuation of other assets	1	-	1
	Revenue recognition	-	1	1
	Accounting	-	1	1
	Environment	-	1	1

	Audit matter topic	KAM	CAM	Combined
Closed-end funds (Number of audit reports: 4 - KAM: 1, CAM: 3)	Valuation of investments	1	-	1
	Other - investments	-	3	3

	Audit matter topic	KAM	CAM	Combined
Communications and media (Number of audit reports: 7 - KAM: 2, CAM: 5)	Valuation of intangible assets, including goodwill	1	4	5
	Accounting	1	1	2
	Revenue recognition	1	-	1
	Business structure events	-	1	1
	Taxes	-	1	1

Appendix B (cont'd)

	Audit matter topic	KAM	CAM	Combined
Consumer products and services (Number of audit reports: 25 - KAM: 17, CAM: 8)	Valuation of intangible assets, including goodwill	8	5	13
	Valuation of fixed assets	5	-	5
	Business structure events	3	1	4
	Revenue recognition	2	2	4
	Matters relating to inventory	2	2	4
	Allowance for losses	2	-	2
	Valuation of investments	1	-	1
	Long-term liabilities	1	-	1
	Taxes	-	2	2

	Audit matter topic	KAM	CAM	Combined
Financial services (Number of audit reports: 38 - KAM: 35, CAM: 3)	Valuation of investments	17	3	20
	Valuation of intangible assets, including goodwill	10	3	13
	Long-term liabilities	10	3	13
	Allowance for loan losses	9	5	14
	Business structure events	7	1	8
	Taxes	3	5	8
	Revenue recognition	2	-	2
	Valuation of other assets	1	3	4
	Accounting	1	-	1
	Other	1	-	1

	Audit matter topic	KAM	CAM	Combined
Industrial products and services (Number of audit reports: 50 - KAM: 35, CAM: 15)	Valuation of intangible assets, including goodwill	15	3	18
	Revenue recognition	8	-	8
	Long-term liabilities	5	2	7
	Other	4	-	4
	Matters relating to inventory	3	-	3
	Valuation of fixed assets	2	5	7
	Business structure events	2	5	7
	Taxes	2	3	5
	Allowance for loan losses	2	-	2
	Valuation of other assets	1	1	2
	Accounting	-	5	5
	Valuation of investments	-	1	1

Appendix B (cont'd)

Audit matter topic		KAM	CAM	Combined
Life sciences (Number of audit reports: 9 - KAM: 2, CAM: 7)	Valuation of intangible assets, including goodwill	1	4	5
	Valuation of investments	1	-	1
	Revenue recognition	1	-	1
	Long-term liabilities	-	2	2
	Matters related to inventory	-	2	2
	Allowance for loan losses	-	1	1
	Valuation of other assets	-	1	1
	Accounting	-	1	1
	Other	-	1	1

Audit matter topic		KAM	CAM	Combined
Mining (Number of audit reports: 71 - KAM: 36, CAM: 35)	Valuation of fixed assets	24	19	43
	Taxes	6	10	16
	Business structure events	4	2	6
	Valuation of intangible assets, including goodwill	3	7	10
	Long-term liabilities	3	1	4
	Valuation of other assets	2	6	8
	No audit matters	2	1	3
	Environment	2	-	2
	Other	2	-	2
	Valuation of investments	1	-	1
	Revenue recognition	1	-	1
	Matters relating to inventory	1	-	1
	Accounting	1	-	1

Audit matter topic		KAM	CAM	Combined
Oil and gas (Number of audit reports: 22 - KAM: 12, CAM: 10)	Impact of oil and gas reserves	6	7	13
	Valuation of fixed assets	5	6	11
	Revenue recognition	2	-	2
	Taxes	1	2	3
	Business structure events	1	1	2
	Valuation of intangible assets, including goodwill	1	1	2
	Allowance for loan losses	-	1	1

Appendix B (cont'd)

Audit matter topic		KAM (27)	CAM (5)	Combined (32)
Real estate (Number of audit reports: 32 - KAM: 27, CAM: 5)	Valuation of investments	23	2	25
	Valuation of intangible assets, including goodwill	2	1	3
	Valuation of fixed assets	2	-	2
	Valuation of other assets	1	-	1
	Environment	1	-	1
	Business structure events	-	3	3
	Revenue recognition	-	1	1
	Long-term liabilities	-	1	1

Audit matter topic		KAM	CAM	Combined
Technology (Number of audit reports: 16 - KAM: 6, CAM: 10)	Revenue recognition	4	9	13
	Valuation of intangible assets, including goodwill	2	3	5
	Valuation of other assets	2	-	2
	Valuation of fixed assets	1	-	1
	Taxes	-	1	1

Audit matter topic		KAM	CAM	Combined
Utilities and pipelines (Number of audit reports: 13 - KAM: 7, CAM: 6)	Valuation of intangible assets, including goodwill	2	5	7
	Valuation of other assets	2	2	4
	Revenue recognition	2	-	2
	Long-term liabilities	2	-	2
	Accounting	1	1	2
	Valuation of fixed assets	1	-	1
	Business structure events	1	-	1

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