



# REAL ESTATE

## CPAB Real Estate Industry Forum Highlights

CPAB held a roundtable on September 26, 2019 in Toronto for audit committee chairs and CFOs of Canadian real estate reporting issuers.

Moderated by **Joanne Ferstman**, audit committee chair of Dream Unlimited, the forum featured discussions about matters top of mind for audit committees and management.

### What's top of mind

#### Investor focus on non-GAAP measures

Investors are relying more and more on non-GAAP measures (non-generally accepted accounting principles) reported by real estate companies to inform their decisions. While some standard guidance exists for these measures, companies often define measures differently.

Participants compared MD&A and non-GAAP measures oversight practices, underscoring that disclosures could largely improve the comparability of measures to industry peers and their usefulness in depicting true company performance.

Audit committee chairs suggested there is a strong case for assurance over non-GAAP measures or management assessment of controls therein (by internal audit). Participants commented that auditor involvement in reviewing measures may be valuable, and that management's assessment should include peer-to-peer comparison and officer representation letters. Other best practices shared include audit committee review of significant estimates and judgments that underlie measures.

Audit committee chairs agreed it will be beneficial for standard setters and regulators to take the lead in advancing non-GAAP measures assurance. CPAB has noted work being carried out by CPA Canada and the Chartered Financial Analyst Institute in this regard.

#### Joint arrangements

IFRS 11, joint arrangements, tightens reporting in terms of revealing the substance of joint arrangements in business combinations. These requirements place increased pressure on the interpretation and application of the definition of a business, leading to more time, cost and effort in financial reporting for some companies.

Participants commented on challenges encountered with US business combinations where lenders require US GAAP compliance. The MD&A has proven useful in providing some lending information requirements.

#### Expanded auditors report – key audit matters coming to Canada

Auditors of large US registrants (including many large dual-listed Canadian reporting issuers) are required to include a discussion of critical audit matters in their audit reports. Reporting of key audit matters for TSX-listed reporting issuers starts in 2020. The UK and other parts of the world adopted expanded reporting of key audit matters in 2016.

Key audit matters, or KAMs, are matters deemed most significant in the financial statement audit in the auditor's professional judgment. Critical audit matters are matters communicated to the audit committee relating to accounts or disclosures that are material to the financial statements and involved especially challenging, subjective, or complex auditor judgment.

Participants plan to conduct KAM reporting dry-runs prior to the 2020 effective date and anticipated that two to three matters will be reported, such as investment property fair value. They also questioned whether expanded reporting requirements may impede the auditor's work.

Certain Canadian audit firms are implementing rigorous quality assurance processes, with the concurrent support of their US audit practice. Some participants raised the matter that to derive value it will be important that these processes produce disclosures that are specific as opposed to boilerplate.

### **Technology advancements and cybersecurity for auditors and reporting issuers**

Audit firm participants shared steps taken to bolster audit practice technology skill sets and cybersecurity posture, including recruiting data science and STEM (science, technology, engineering and math) professionals, expanded use of data analytics and policies restricting client data storage.

Audit committee chairs commented that the introduction of property technology in real estate has increased cyber exposure, recommending that cyber attack crisis plan simulations and educating staff regarding cyber security dos and don'ts is paramount.

## **What's new at CPAB**

### **Quality management systems**

Increased focus on quality management systems at the firm level is important to improve the consistency of audit quality. While most audits CPAB inspects comply with the required standards, recurring file inspection themes indicate that weaknesses in quality management systems persist, leading to inconsistent audit execution. Firm policies and processes – at both the leadership and engagement team levels – that manage risk and get the right people working on the right things at the right time are essential to delivering high quality audits, consistently.

In 2018, CPAB implemented a new methodology to assess existing audit quality management systems to help accelerate improvements. It is our perspective that when firms place greater focus on strong, quality management systems, this better supports engagement teams to drive more consistent quality audits. When evaluating firm processes, CPAB expects the firm to demonstrate and evidence the effectiveness of the underlying processes. Participants discussed their experiences with certain quality management systems criteria, such as firm resource management, as areas they were interested in exploring with a direct link to audit quality results.

CPAB will report findings from our assessment of Canada's four largest public accounting firms' quality management systems in March 2020.

### **CPAB explores going concern and fraud**

Recent global corporate collapses have turned the spotlight on auditors and whether they are thinking enough about forward-looking trends and risks to the future performance of public companies.

CPAB is reviewing going concern and fraud - areas that have critical impact on the investing public. We're looking at the work performed with respect to the auditor's responsibility related to fraud and the auditor's responsibility relating to management's going concern disclosure. In the area of going concern, we are also carefully assessing proposed new going concern standards in other jurisdictions.

Participants emphasized the importance of audit committee discussion regarding substantial whistleblower incidents.

Participants also commented that it is important that going concern assessments consider broader reporting issuer risks and understanding of the enterprise risk management plan. While the real estate industry is relatively stable today, industry challenges remain.

## On the global stage

**CPAB is looking at how Canada might be impacted by several global developments.**

### Market concentration

Amid increasing scrutiny from politicians and regulators in the wake of high-profile corporate collapses, structural change of Big Four firms in the UK is being considered. This includes discussing steps to increase competition for large audits and to reduce the potential for conflicts of interest.

Audit committee chairs commented that where barriers to entry for small firms exist (due to Big Four dominance), regulator involvement may be beneficial.

### Auditor selection and appointment

Mandatory auditor rotation has been introduced in jurisdictions such as the UK where it was thought that rotation would improve competition among firms and improve audit quality.

### Separation of audit and non-audit services

Functional or operational separation of the audit and non-audit businesses at the large audit firms is being considered in other jurisdictions. While global audit firms continue to explore this, all agree that implementing internal controls at the firm level and a greater focus on quality processes and systems and the key players in the audit ecosystem (auditors, audit committees and management) is required.

### Audit firm governance and organizational culture

A strong organizational culture keeps company core values at the forefront of all aspects of operations, propels performance and drives stakeholder value. In the audit firm context, this value ultimately supports audit quality.

Equally important to protect stakeholder value is sound corporate governance. How the cultural dynamics and good governance practices of audit firms are modeled is being explored as an area that can improve audit quality.

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## Thank you

CPAB thanks everyone for their participation. We encourage ongoing dialogue and look forward to continuing the audit quality discussion at future events across Canada.

## Have a view?

CPAB would appreciate hearing from you. Please reach out to us at [stakeholderengagement@cpab-ccrc.ca](mailto:stakeholderengagement@cpab-ccrc.ca).

### Learn More

Visit us at [www.cpab-ccrc.ca](http://www.cpab-ccrc.ca) and join our mailing list. Follow us on Twitter — @CPAB-CCRC

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