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Canadian Public
Accountability Board

Conseil canadien sur
la reddition de comptes

CPAB Exchange: Inspections Forum Series

Inspiring dialogue that accelerates audit quality

November 18, 2020

Virtual meeting etiquette



Please **mute** your line and turn your **video off** when not speaking.



If poor voice quality is experienced, dial into the meeting conference call line by phone **(1-416-216-5643; ID: 132 727 4795#)**.



If you still have technical issues, contact the CPAB IT Help Desk email jay.sachapara@cpab-ccrc.ca or call (416) 941-2526.



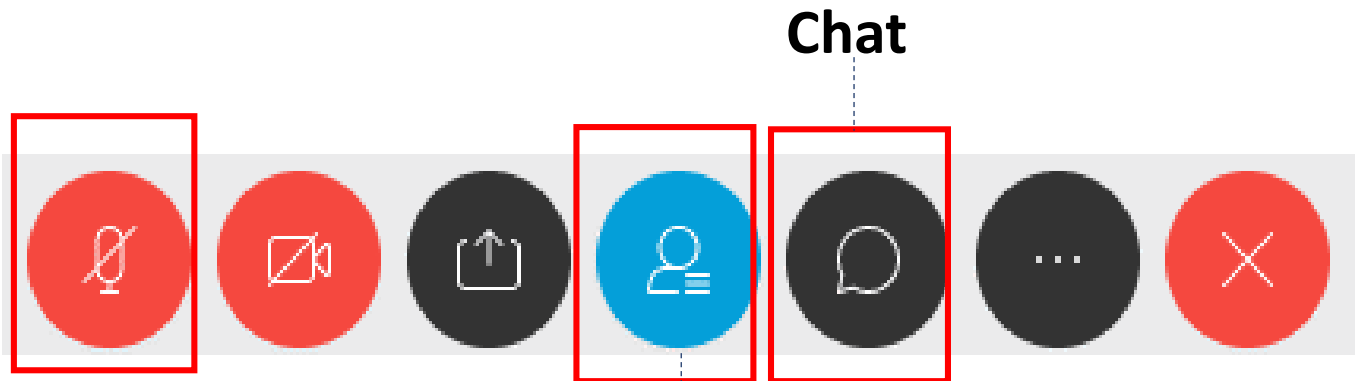
Have questions? Ask them using the WebEx **chat**.



Forum is being **recorded**. Recording and presentation materials will be provided to participants.

Please go ahead and...

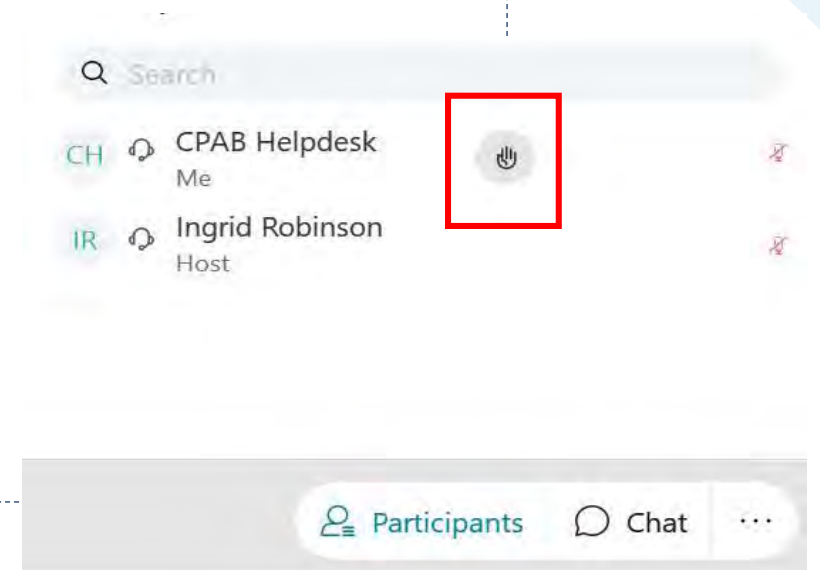
Mute your **microphone** and familiarize yourself with WebEx **chat** and **raise hand** buttons.



Mute

Chat

Raise / Lower Hand



Please go ahead and...

Log into PollEverywhere: www.PollEv.com/cpab.

(using your mobile phone or PC)

Poll questions will appear during the forum.



Agenda



1:00 pm Welcome



1:05 pm Opening remarks



1:15 pm Business combinations



1:45 pm Estimates – Impairment of long-lived assets



2:15 pm Break



2:25 pm Inventory



2:55 pm Emerging industries – Cannabis



3:20 pm Closing remarks

Opening remarks

Carol Paradine
Chief Executive Officer





Inspection remarks

Malcolm Gilmour
VP Inspections

Topic presenters



PIA HEINEMANN

Director, Inspections

Toronto

**Business
Combinations**



GLORIA VOPNI

Director, Inspections

Toronto

**Estimates – Impairment
of long-lived assets**



SADIA KHAN

Director, Inspections

Toronto

Inventory



RESHMA MAHASE

Director, Inspections

Vancouver

**Emerging Industries
(Cannabis)**





**Business
combinations**

Audit requirements

CAS
540



CAS
701



Audit requirements

CAS
540

Auditing Accounting Estimates and Related Disclosures



- Why the need for **change**?
- **December 15, 2019**
- Greater focus on **professional skepticism**

CAS

Audit requirements

CAS
540

Auditing Accounting Estimates and Related Disclosures



- Why the need for **change**?
- **December 15, 2019**
- Greater focus on **professional skepticism**
- Risk = **estimation uncertainty, complexity** and **subjectivity**
- Testing strategies consistent with extant CAS 540
- Changes in **communication requirements**

CAS

Audit requirements

**CAS
701**

**Communicating key audit matters
in the independent auditor's report**

Audit requirements

CAS
701

Communicating key audit matters
in the independent auditor's report

- **December 15, 2020** (for most TSX listed companies)
- No longer a standard report format

Audit requirements

CAS
701

Communicating key audit matters in the independent auditor's report

- **December 15, 2020** (for most TSX listed companies)
- No longer a standard report format
- Enhanced **communicative value**
- KAMs can be a significant or higher **risk**, significant **estimate**, and/ or significant **transaction/ event**

Common inspection findings

01

*“Key assumptions used in the valuation models to assess the reasonableness of the estimated fair values of acquired assets were **not adequately tested.**”*



02

*“**Sufficient appropriate audit evidence was not obtained** to support the fair value of the convertible debentures issued.”*



03

*“The engagement team did not obtain sufficient appropriate audit evidence to support the **existence, completeness and accuracy** of the intangible asset acquired.”*



04

*“The engagement team did not evaluate whether the **provisional fair value estimates** of the intangible assets and goodwill were reasonable.”*



- Question 2
- Question 1
- Audit Approach
- Scenario

CASE SCENARIO

“Oscorp Acquisition”



Scenario – Part 1

On April 30, 2020, Wayne Enterprises Inc. (“Wayne”) acquired all the issued and outstanding shares of Oscorp for **total consideration of \$150 million**. Wayne is a Canadian-based toy manufacturer and **trades on the TSX-V**. They **acquired US based Oscorp**, primarily to get a foothold in the US market. Oscorp sells to a large network of US retailers. The purchase consideration consisted of \$80 million cash and the following:

- 1 Common shares of Wayne valued at \$50 million** based on the number of shares per the agreement and closing price on April 30. The common shares **do not have regular trading frequency** and are **subject to a two-year escrow**.
- 2 An additional amount payable in five years**, provided Oscorp meets future EBITDA targets over the same period. The **contingent consideration was valued at \$20 million**.



Audit Approach

The audit team identified the following significant risk:
The purchase consideration issued may not be fair valued appropriately.

Materiality: \$1 million

The audit team performed the following procedures:

- 1** Agreed the price of the common shares to the **closing share price per TSX-V and the share purchase agreement.**
- 2** Agreed EBITDA targets to Oscorp's **audited financial statements for the past five years** and verified that the earnout threshold was previously met.



Question 1 – Share consideration

The price of the common shares was agreed to the closing share price per TSX-V and the share purchase agreement. The common shares do not have regular trading frequency and are subject to a two-year escrow.

What additional audit procedures would you perform to audit the fair value of the common shares?

[Hint: Consider all the different inputs that would determine fair value.]



Question 1

Audit Approach

Scenario

Question 2 – Contingent consideration

Wayne management is confident that Oscorp will meet the stipulated EBITDA targets based on their historical performance which was agreed to their audited financial statements. Therefore, they expect to pay the full amount of the contingent consideration.

Which of the following should the audit team consider? [You can select more than one answer.]

- A** Past performance is usually a good predictor of future performance.
- B** The liability has been fair valued appropriately.
- C** Management is conservative because they recorded the full amount of the liability.
- D** The audit team needs to obtain more audit evidence to determine if recognizing the full liability was appropriate.



Scenario – Part 2

Oscorp manufactures and distributes super-hero themed clothing and has recently launched a very successful line of running shoes for which a **patent is pending**. Oscorp's former owner has signed a **non-compete agreement** which prevents her from starting any clothing manufacturing business in the state of New York for a period of one year from closing.

Wayne management has identified and recognized the following intangible assets:

- A **customer relationship intangible** for \$50 million, with a useful life of 15 years, which was valued by a reputable third-party valuator.
- A **patent in progress** in the amount of \$10 million as determined by the valuator, with a useful life of 10 years.
- **Goodwill** in the amount of \$10 million.

The **non-compete and brand name** were deemed to have a **nil value**.

Audit Approach

The audit team identified the following significant risk:

Assumptions used in determining the fair value for intangible assets acquired may not be appropriate and may not be supported.

The audit team performed the following procedures:

Patent in progress, customer relationships and goodwill: The audit team utilized their **valuations group** to review the procedures performed by the valuator. They agreed with the valuator's conclusions. The audit team is responsible for testing all significant cash flow assumptions.



Question 1 – Intangibles

With respect to the valuation of the customer relationship, the audit team noted the following assumptions:

- Useful life and forecast period of 15 years.
- Customer revenues project a sharp downturn in 2020 and strong recovery thereafter.
- EBITDA margin improved 10% compared to prior year actual due to cost savings.

Which of the following applies? [You can select more than one answer.]

- A** Management's assumptions appear too optimistic and they may have intentionally overstated the customer relationship intangible.
- B** It looks like management has appropriately factored in the current economic uncertainty.
- C** The audit team should not be too concerned as any valuation error would just be a balance sheet reclass between goodwill and intangibles.
- D** It is hard to say because it depends.



Question 2 – Intangibles

Looking at the identified intangibles below, other than valuation of the recorded intangibles:

What are some other risks or assertions you would be concerned with?

- A **customer relationship intangible** for \$50 million which was valued by a reputable third-party valuator.
- A **patent in progress** in the amount of \$10 million as determined by the valuator.
- **Goodwill** in the amount of \$10 million.

The **non-compete** and **brand name** were deemed to have a **nil value**.



Nov 18 - CPAB Inspections Forum - Business Combination

Poll questions answers

4

Activities

24

Participants

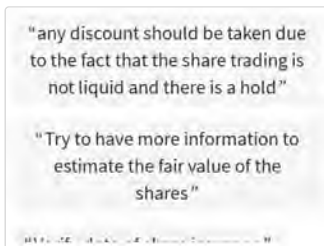
23

Average responses



Average engagement

What additional audit procedures would you perform to audit the fair value of the common shares?



Responses

- any discount should be taken due to the fact that the share trading is not liquid and there is a hold
- Try to have more information to estimate the fair value of the shares
- Verify date of share issuance
- consider what effect shares being held in escrow would have on value.
- Compare to recent issuances. Nothing else send a confirmation
- Determine if there was any recent issuances around the similar time period.
- Agree to agreements none Confirmation None

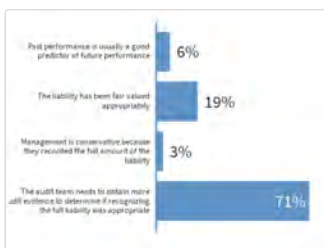


Engagement

12

Responses

Which of the following should the audit team consider?



Response options

- Past performance is usually a good predictor of future performance
- The liability has been fair valued appropriately
- Management is conservative because they recorded the full amount of the liability
- The audit team needs to obtain more audit evidence to determine if recognizing the full liability was appropriate**

Count Percentage

2	6%
6	19%
1	3%
22	71%

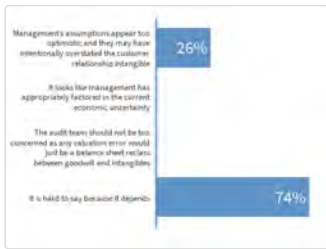


Engagement

31

Responses

Which of the following applies?



Response options	Count	Percentage
Management's assumptions appear too optimistic and they may have intentionally overstated the customer relationship intangible	10	26%
It looks like management has appropriately factored in the current economic uncertainty	0	0%
The audit team should not be too concerned as any valuation error would just be a balance sheet reclass between goodwill and intangibles	0	0%
It is hard to say because it depends	28	74%

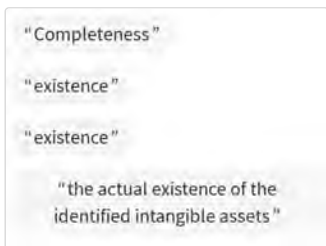
96%

Engagement

38

Responses

What are some other risks or assertions you would be concerned with?



Responses

Completeness	existence	existence	Completeness
the actual existence of the identified intangible assets			completeness
existence of the customer relationships	Existence	Completeness	

38%

Engagement

9

Responses

Auditing in the current environment



Access



Technology



Key takeaways – Business Combinations



Review the underlying agreements

To ensure all relevant facts have been appropriately identified and assessed by management.



Consideration

Purchase consideration can come in many forms and its fair valuation can be complex.



Assertions

Ensure you consider all the relevant assertions.



New standards are on the way!

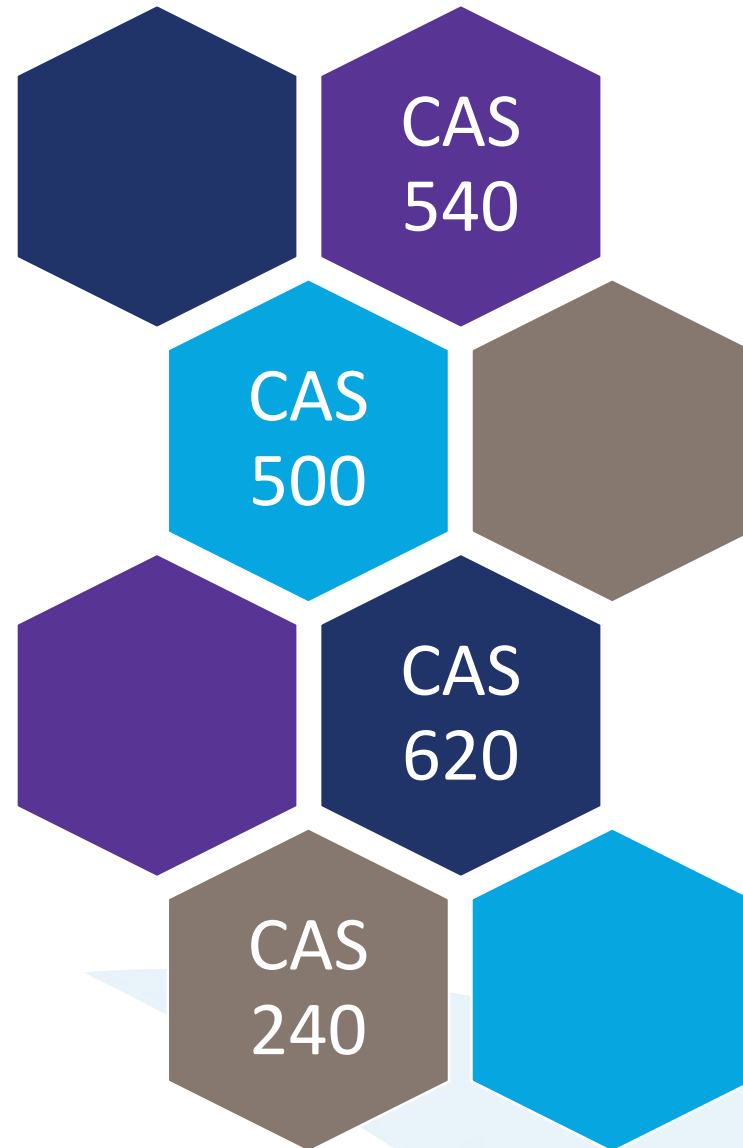
CAS 540 impacts how estimates are audited, and CAS 701 significantly changes auditor communications.

A dramatic, stormy sky with dark, heavy clouds in shades of blue and purple. A bright lightning bolt is visible in the lower right corner. A large, semi-transparent, dark blue arrow shape points from the left towards the text.

Estimates

Impairment of long-lived assets

Audit requirements



Audit requirements

CAS
540

**Auditing Accounting Estimates and
Related Disclosures**

Audit requirements

CAS
500

Audit Evidence

500

Audit requirements

CAS
620

**Using the Work of an Auditor's
Expert**

CAS

Audit requirements

620

CAS
240

**The Auditor's Responsibilities
relating to Fraud in an Audit of
Financial Statements**

Common inspection findings

01

*“The engagement team did not obtain sufficient appropriate audit evidence over certain **key assumptions used in the impairment models** such as revenue, EBITDA, capital expenditures...”*



02

*“The engagement team did not perform a **sufficient retrospective review.**”*



03

*“The engagement team did not perform sufficient audit procedures to assess the **appropriateness of the cash generating unit** identified by management for goodwill impairment purposes”*



04

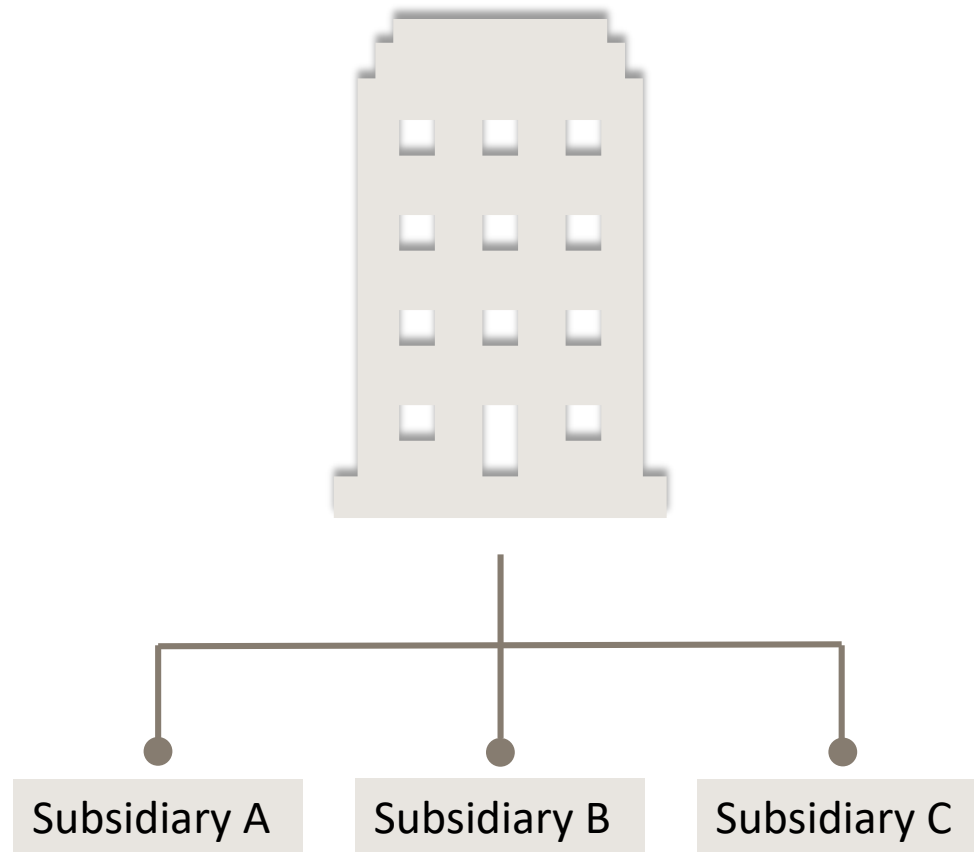
*“The engagement team **relied solely on inquiry with management** to support management’s impairment assessment”*



Question 2
Audit Approach
Scenario
Question 1
Audit Approach
Scenario

CASE SCENARIO

“Wayne Enterprises”



Scenario

Wayne Enterprises. is publicly traded in Canada and has three subsidiaries:

- Toys Inc. – manufactures and sells toys
- Oscorp – sells clothing
- Oscorp 2 - manufactures and sells running shoes

In performing its annual assessment of recoverable amounts, management used an external expert to assist in the determination of the VIU of each CGU.

Revenue and EBITDA have been relatively flat in recent years; however the new Chief Executive Officer (CEO) has significant plans to turn the company around.



Audit Approach

The audit plan included the following:

- 1 Materiality = \$1 million
- 2 Identified Significant Risk: Valuation of goodwill and intangible assets, specific to:
 - Growth rates used; and
 - Discount rate
- 3 Valuation specialist to assist in the audit of the CGU valuations.

Question 2

Audit Approach

Scenario

Question 1



Audit Approach

Scenario

Question 1

Based on the facts presented, what are the areas you may want to focus on?

- A** Management's assessment of the CGU determination.
- B** The established responsibilities of the auditor and the specialist.
- C** Both management and the auditor have engaged a specialist, so we are good to go!
- D** A and B.



Scenario – additional facts

Management's Toys Inc. impairment test:

Recoverable amount (VIU) was based on a DCF model with the following key inputs:

- Revenue and EBITDA inputs were provided by management for years 1-10
 - Year 1 = prior year actual (audited).
 - Years 2 and 3 = 20% growth rate.
 - Years 4-10 = 6% growth rate.
- Management's specialist determined the terminal growth rate and discount rates used.



Audit Approach

In addition to assessing management's expert's concluding memo (VIU of Toys Inc. > carrying value by \$2 million), the audit team performed the following procedures related to the Toys Inc. VIU growth rates:

- 1 Performed a retrospective review (3 years): actual revenue < budgeted revenue each year and the average growth rate was 2%.
- 2 Inquired with CEO / obtained the board approved budget that supported the growth rates utilized in the VIU model.
- 3 Obtained an industry trend report (Europe) → sales in industry are expected to increase by 10% in each of the next 2 years!

Question 3

Audit Approach

Scenario

Question 2



Audit Approach

Scenario

Question 2

Based on the additional facts, what are your key concerns?

- A** Based on the retrospective review, average growth rates have been 2% - this does not support the future expected growth.
- B** The audit team seems to be giving greater weight to internal evidence to support the growth rates – specifically the inquiry with CEO / board approved budget.
- C** The impairment model is based on a ten-year forecast.
- D** The external support used (industry trend report) is based on the European market, not North America where Toys Inc. operates.

Question 3

Audit Approach

Scenario



Question 2

Audit Approach

Scenario

Scenario – additional facts

Management's expert determined the discount rate of 16% was comprised of the following:

- Risk-free rate 2%
- Equity risk premium 7%
- Size premium 2%
- Company specific risk 2%
- Cost of debt 3%

Audit Approach

The auditor's expert performed the following procedures:

Developed a range of acceptable discount rates based on the following:

- Risk-free rate 2%
 - Equity risk premium 6%
 - Size premium 2%
 - Company specific risk 1-7%
 - Cost of debt 3%
- Used 12 comparable companies in the assessment of the discount rate.
 - Determined an acceptable range of 14-20% (resulting in Toys Inc. VIU of \$45-60 million, carrying value is \$50 million).

Question 3

As the auditor, where do you want to focus?

- A** No issues noted as the discount rate selected by management's expert is within the acceptable range of discount rates determined by the auditor's expert and the comparable companies.
- B** The auditor's expert used 12 comparable companies – the more the better!
- C** The discount rate range determined by the auditor's expert results in a range that is multiples of materiality - I want to understand that better.
- D** The auditor's expert used 12 comparable companies – I want to understand how they were determined to be comparable.



CPAB Inspections Forum: Estimates

Poll questions answers

3

Activities

22

Participants

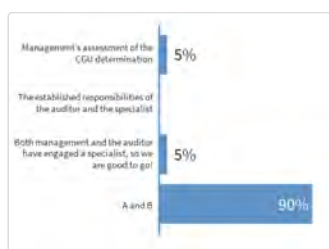
36

Average responses



Average engagement

Based on the facts presented, what are the areas you may want to focus on?



Response options	Count	Percentage
Management's assessment of the CGU determination	1	5%
The established responsibilities of the auditor and the specialist	0	0%
Both management and the auditor have engaged a specialist, so we are good to go!	1	5%
A and B	19	90%

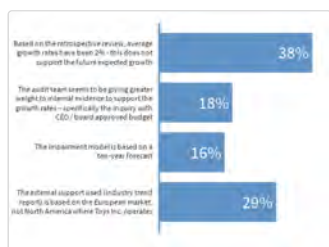


Engagement

21

Responses

Based on the additional facts, what are your key concerns?



Response options	Count	Percentage
Based on the retrospective review, average growth rates have been 2% - this does not support the future expected growth	21	38%
The audit team seems to be giving greater weight to internal evidence to support the growth rates - specifically the inquiry with CEO / board approved budget	10	18%
The impairment model is based on a ten-year forecast	9	16%
The external support used (industry trend reports) is based on the European market, not North America where Toys Inc. operates	16	29%

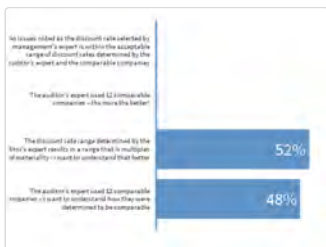


Engagement

56

Responses

As the auditor, where do you want to focus?



Response options

Count Percentage

No issues noted as the discount rate selected by management's expert is within the acceptable range of discount rates determined by the auditor's expert and the comparable companies

0 0%

The auditor's expert used 12 comparable companies - the more the better!

0 0%

The discount rate range determined by the auditor's expert results in a range that is multiples of materiality - I want to understand that better

16 52%

The auditor's expert used 12 comparable companies - I want to understand how they were determined to be comparable

15 48%

86%

Engagement

31

Responses

Auditing in the current environment



Reliability of
forecasts



Professional
skepticism



Fraud conditions

Key takeaways – Estimates – Impairment of long-lived assets



The auditor is responsible for the work performed by the auditor's experts.



When **estimation uncertainty, complexity or subjectivity are very high**, audit procedures are expected to be much **more persuasive**.



If management has not taken appropriate steps to address estimation uncertainty, **request management to perform additional procedures**.



New environment - Be prepared for many new challenges and ensure that the big picture makes sense.

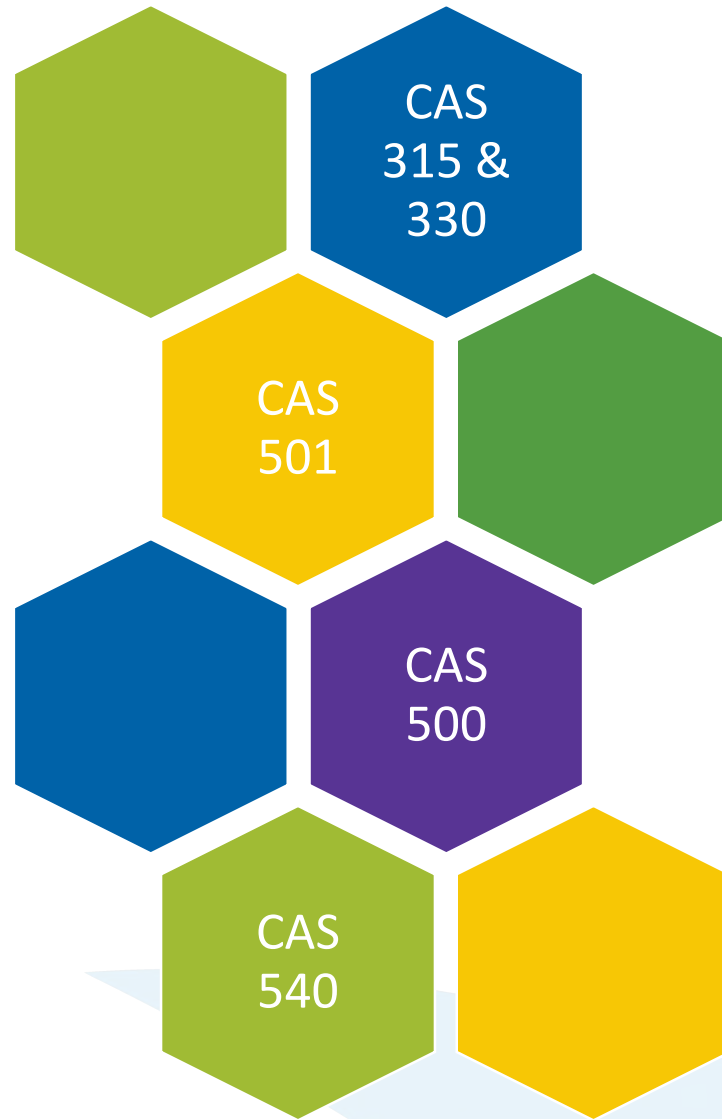


BREAK
10 minutes



Inventory

Audit requirements



Audit requirements

CAS
315 &
330

Obtaining an understanding of the entity and its environment and internal controls and assessing the risks.

Audit requirements

315 &
330

CAS
501

**Audit Evidence: Inventory Existence
and Completeness**

CAS
500

Audit requirements

CAS
500

Audit Evidence: Accuracy and Valuation

Audit requirements

CAS
540

Estimates: Inventory Provision

Common inspection findings

01

*“The engagement team **did not obtain a sufficient understanding of the inventory process** to identify, prior to year-end, the need to observe management’s physical inventory...”*



02

*“...Insufficient audit evidence to support **the completeness and existence** of certain raw material balances at year end...”*



03

*“...**no audit procedures** were performed over the appropriateness of the **buildup of the standard costs** or the **allocation of overhead costs** included in inventory at the year end.”*



04

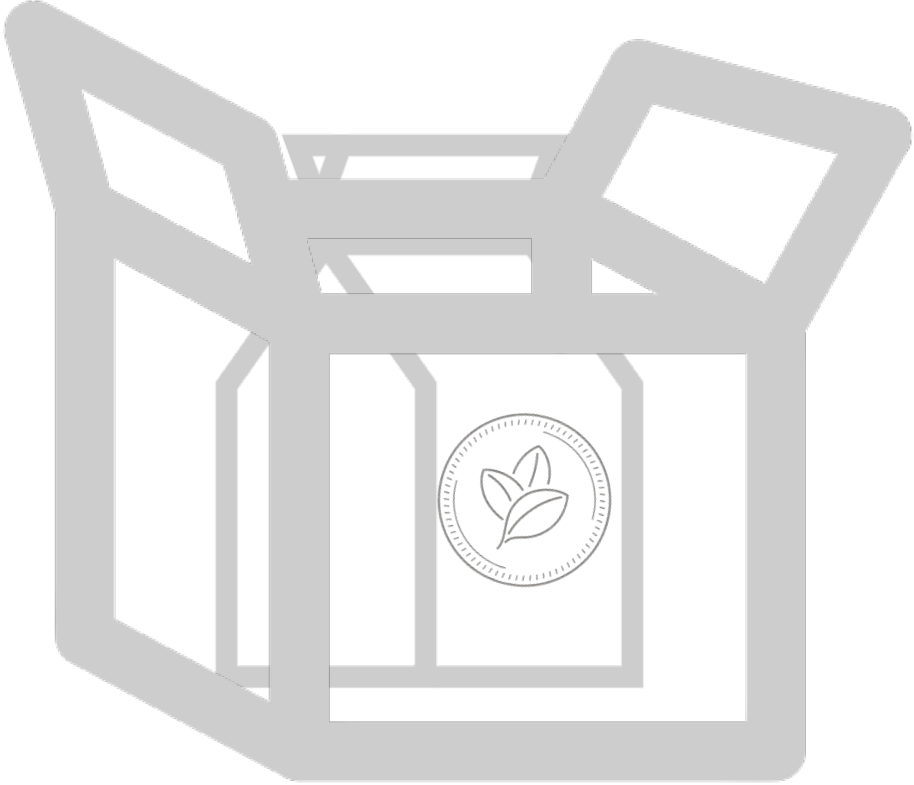
*“...did not obtain sufficient **appropriate audit evidence** for the **basis for the inventory provision** and **inventory expiry dates** used to determine the inventory write-downs...”*





CASE SCENARIO

“NRV Inc.”



Scenario

NRV Inc. is a Canadian reporting issuer that manufactures organic food and beverage products. They sell repackaged bulk products and manufacture food products. Raw materials consist of fruits purchased at varying prices.

- Year-end: June 30, 2020.
- Inventory: \$150 million.
- Inventory provision: \$10 million.
- NRV Inc. maintains a perpetual inventory system.
- 7 owned manufacturing facilities across Canada.
- Certain inventory is held in 3 separate third-party warehouses at year-end.



Audit Approach

The audit team identified a **significant risk** that inventory may not **exist, be incomplete or inaccurate**.

Materiality is calculated at \$5 million.

The audit team performed the following procedures over the **completeness and existence** of inventory:

Attended and observed the counts at the three largest manufacturing facilities at May 31, 2020.



Question 2

Question 1



Audit Approach

Scenario

Question 1 – Risk Assessment

Based on the case facts, what are the risks related to Inventory?

- A** Inventory may not exist, be incomplete or inaccurate is a **significant** risk.
- B** Inventory may not be accurate is a **low** risk.
- C** Inventory may not exist or be incomplete is a **low** risk.
- D** Inventory provision may be understated is a **significant** risk.



Question 2 – Inventory Counts

What other audit procedures do you think the audit team could perform over the completeness and existence of inventory?

- A** No further audit procedures required because the audit team attended counts at locations that covered a significant portion of the inventory balance.
- B** The operating effectiveness of controls should have been tested.
- C** Inventory held with third parties should have been counted.
- D** Inventory held with third-parties should have been confirmed.
- E** Rollforward procedures should have been performed for counts performed at May 31 to the year-end, June 30.



Scenario

NRV Inc. is a Canadian reporting issuer that manufactures organic food and beverage products. They sell repackaged bulk products and manufacture food products. Raw materials consist of fruits purchased at varying prices.

- Year-end: June 30, 2020.
- Inventory: \$150 million.
- Inventory provision: \$10 million.
- NRV Inc. maintains a perpetual inventory system.
- 7 owned manufacturing facilities across Canada.
- Certain inventory is held in 3 separate third-party warehouses at year-end.



Audit Approach – Valuation

In addition to the **significant risk** that **inventory may not be accurate** another **significant risk** was identified that the **inventory provision may be understated**.

Materiality is calculated at \$5 million.

The audit team performed the following procedures over the **accuracy** of inventory costs :

- 1 Performed non-statistical sample testing over the inventory costs.
- 2 Obtained management's policy and calculation over the inventory provision and recalculated the provision.



Question 2

Question 1



Audit Approach

Scenario

Question 1 – Inventory Costs

What are other audit procedures the audit team could perform over the inventory costs?

- A The procedures performed by the audit team appear reasonable.
- B IT control testing over inventory costs should have been performed.
- C Substantive procedures should have been designed separately for each type of inventory (i.e. packaged and manufactured inventory).
- D Substantive procedures should have been designed separately for each type of inventory (i.e. raw materials, work-in-process, finished goods).



Question 2 – Inventory Provision

What are other audit procedures the audit team could perform over the inventory provision?

- A** The procedures performed by the audit team appear reasonable.
- B** Evaluate the reasonableness of the inventory policy.
- C** Consider the completeness and accuracy over the inputs within the provision calculation.
- D** Evaluate the design and implementation of controls over the inventory provision calculation.



Nov 18 - CPAB Inspections Forum - Inventory

Poll questions answers

4

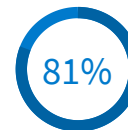
Activities

20

Participants

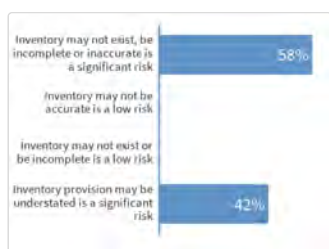
29

Average responses



Average engagement

Based on the case facts, what are the risks related to Inventory?



Response options

Inventory may not exist, be incomplete or inaccurate is a significant risk

Inventory may not be accurate is a low risk

Inventory may not exist or be incomplete is a low risk

Inventory provision may be understated is a significant risk

Count Percentage

14 58%

0 0%

0 0%

10 42%

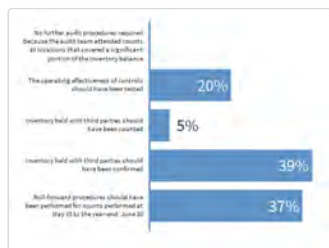


Engagement

24

Responses

What other audit procedures do you think the audit team could perform over the completeness and existence of inventory?



Response options

No further audit procedures required because the audit team attended counts at locations that covered a significant portion of the inventory balance

The operating effectiveness of controls should have been tested

Inventory held with third parties should have been counted

Inventory held with third parties should have been confirmed

Roll-forward procedures should have been performed for counts performed at May 31 to the year-end, June 30

Count Percentage

0 0%

8 20%

2 5%

16 39%

15 37%



Engagement

41

Responses

What are other audit procedures the audit team could perform over the inventory costs?



Response options	Count	Percentage
The procedures performed by the audit team appear reasonable	0	0%
IT control testing over inventory costs should have been performed	0	0%
Substantive procedures should have been designed separately for each type of inventory (i.e. packaged and manufactured inventory)	5	26%
Substantive procedures should have been designed separately for each type of inventory (i.e. raw materials, work-in-process, finished goods)	14	74%

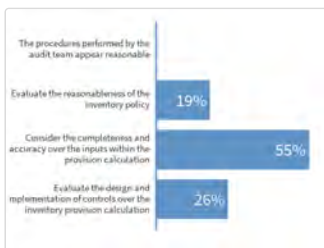
70%

Engagement

19

Responses

What are other audit procedures the audit team could perform over the inventory provision?



Response options	Count	Percentage
The procedures performed by the audit team appear reasonable	0	0%
Evaluate the reasonableness of the inventory policy	6	19%
Consider the completeness and accuracy over the inputs within the provision calculation	17	55%
Evaluate the design and implementation of controls over the inventory provision calculation	8	26%

85%

Engagement

31

Responses

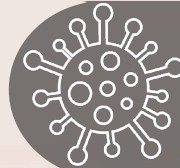
Auditing in the current environment



Technology

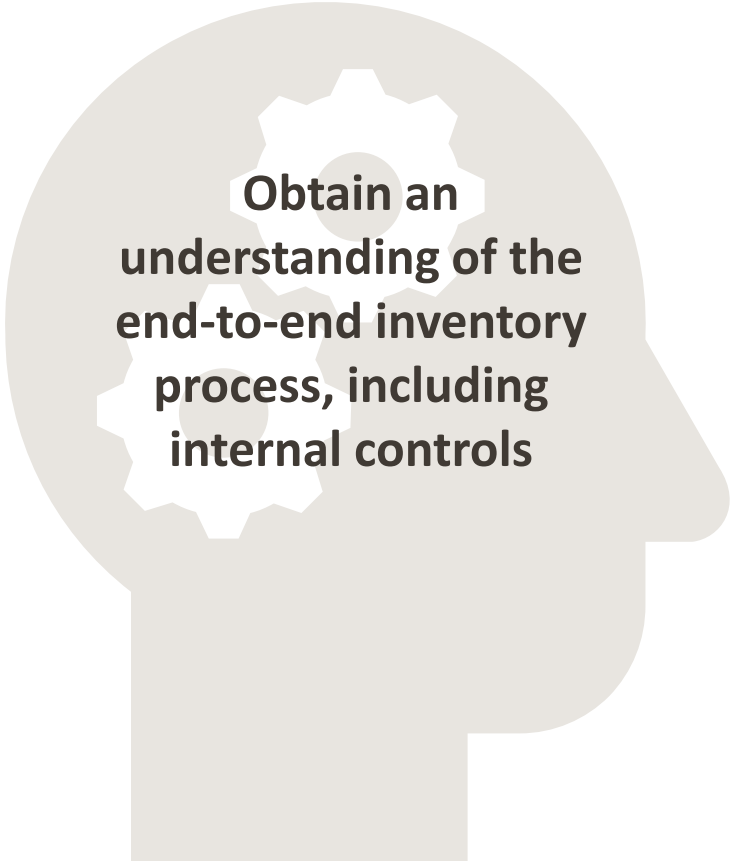


Complexity



COVID-19

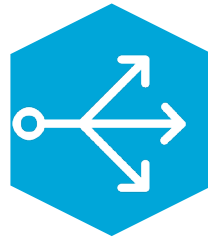
Key takeaways - Inventory



Obtain an understanding of the end-to-end inventory process, including internal controls



Importance of planning the audit approach over the completeness and existence of Inventory



Incorporating an audit approach over the different types of inventory costs



Applying CAS 540 when considering Inventory provisions



Emerging Industries

Cannabis

Overview



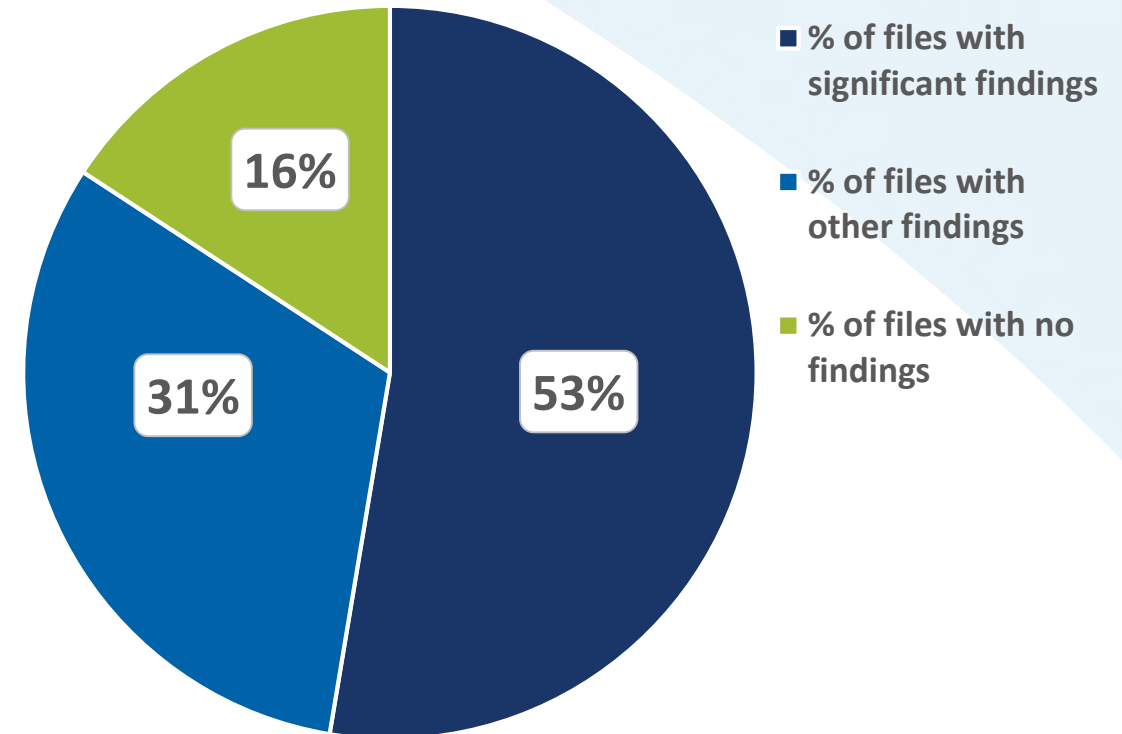
Reporting Issuers

~ 250 in Canada



Market Capitalization

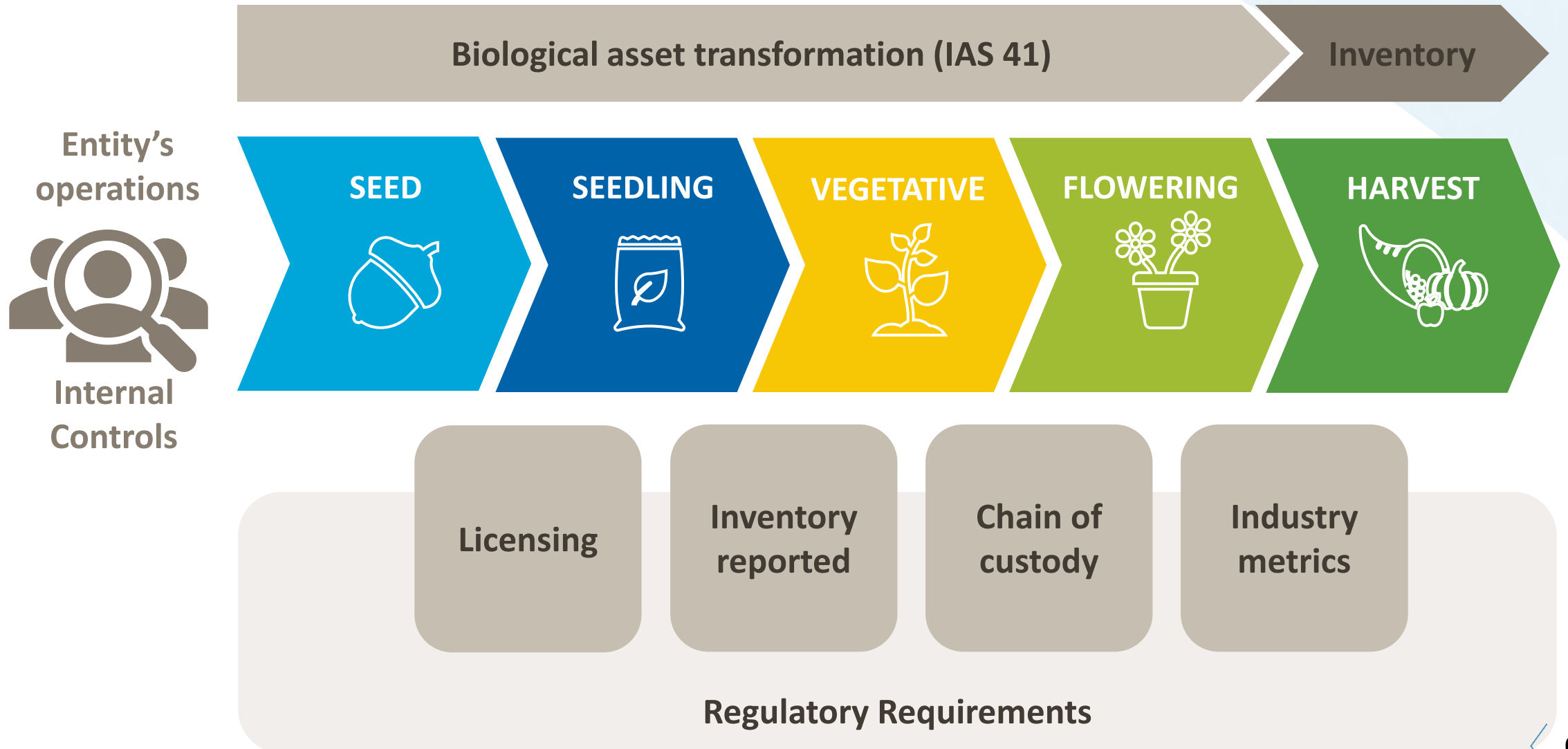
\$26 billion (December 31, 2019)



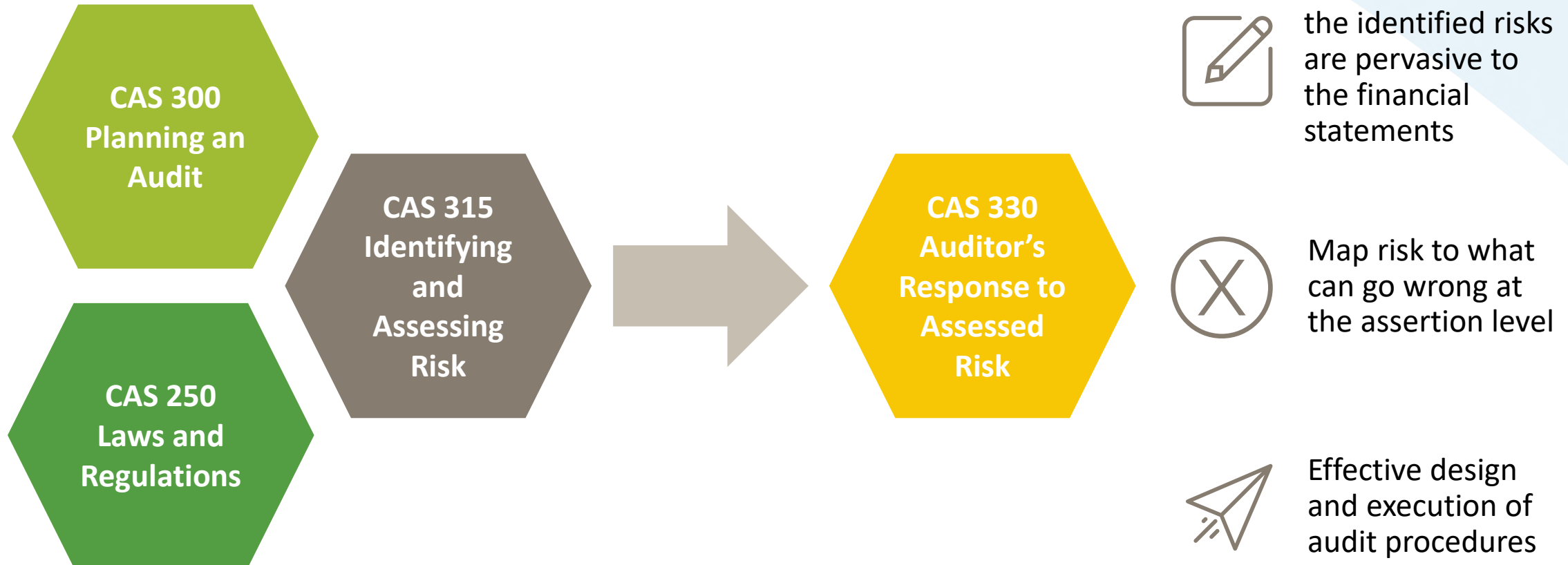
A significant inspection finding is defined as a deficiency in the application of generally accepted auditing standards related to a material financial balance or transaction stream where the audit firm must perform additional audit work to support the audit opinion and/or is required to make significant changes to its audit approach. CPAB requires firms to carry out additional audit procedures to verify there was no need to restate the financial statements due to material error, or to substantiate that they had obtained sufficient and appropriate audit evidence with respect to a material balance sheet item or transaction stream to support their audit opinion.

Other findings – A noted deficiency in the application of generally accepted auditing standards related to a material balance sheet item or transaction stream where CPAB is able to conclude, without the engagement team performing additional procedures to support the audit opinion, that the deficiency is unlikely to result in a material misstatement. These findings, while not significant, indicate areas for improvement.

What to focus on?



How does the focus map to the audit requirements?



Common inspection findings

01

*“There was insufficient evidence to support the **yields** and **lifecycle** used in determining the fair value biological assets specifically as the RI operated indoor, outdoor and greenhouse facilities.”*



02

*“There was insufficient evidence to support compliance with **laws and regulations** and impact on inventory and biological assets”*



03

*“The audit file did not demonstrate sufficient appropriate audit evidence over the **standard costs** incurred to date and total expected costs used in determining the fair value of biological assets”*



04

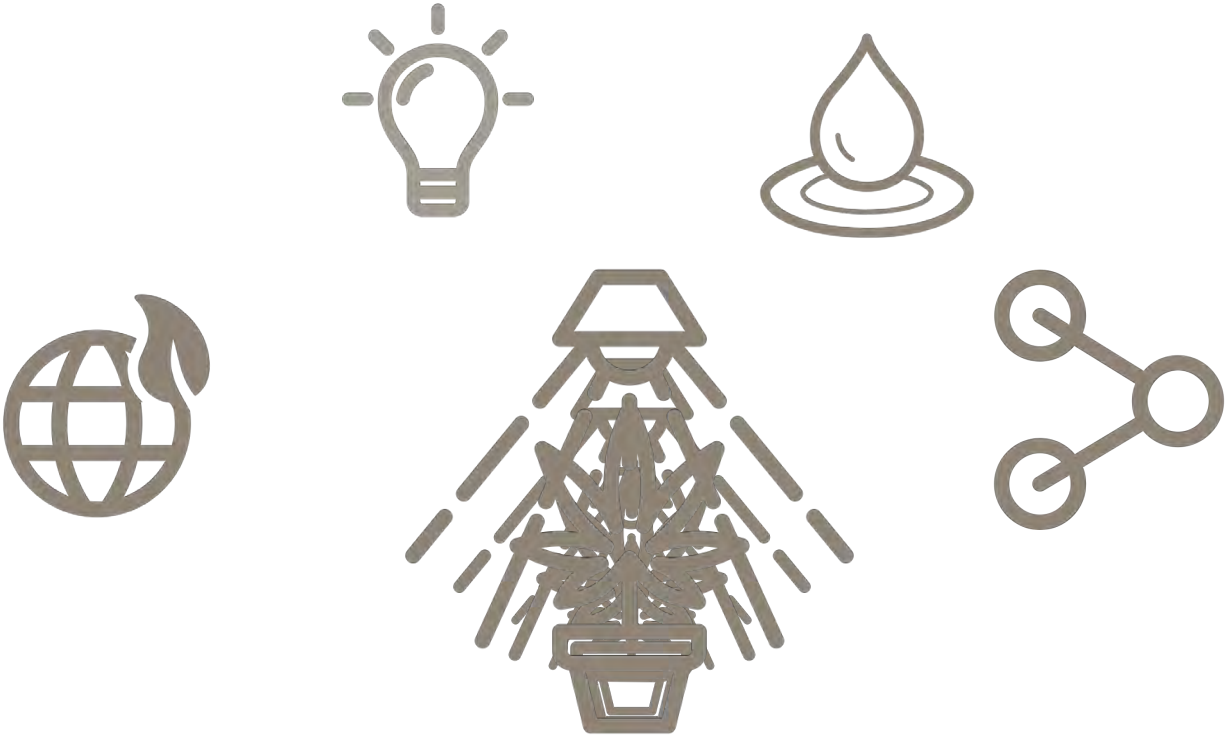
*“Sufficient appropriate audit evidence was not obtained to support the reasonableness of **average selling prices** used in determining the fair value of biological assets”*



CASE SCENARIO

“LeaflyCBD Inc.”

- Question 4
- Question 3
- Audit Approach
- Question 2
- Question 1
- Audit Metrics
- Scenario



Scenario

- Question 4
- Question 3
- Audit Approach
- Question 2
- Question 1
- Audit Metrics

- LeaflyCBD Inc. (Leafly) is a publicly listed company in Canada and has **over 1 million sq. ft of licensed grow facilities** in the **United States (360,000 sq. ft)** and **Canada (640,000 sq. ft)**.
- Leafly has **indoor, outdoor and greenhouse** grow facilities, supplies cannabis to provinces in Canada and **produces and sell** cannabis in Nevada (recreational and medicinal).
- Leafly’s Director of Finance (DOF) prepares a **fair value model** based on stage of growth and under IAS 41 for **all** biological assets. The model utilizes the **historical** data and key inputs from Leafly’s US **indoor facility** which has been in operation since **2017**.
- The DOF uses the **count items** from the **biological asset count** as a key input in the **fair value model**.



Scenario

Audit metrics

Materiality: \$ 6 million

Biological Assets: \$ 80 million

Inventory: \$ 102 million

Revenues: \$ 298 million

Year-end: December 31, 2019

Significant Risk: Valuation of Biological Assets – Estimates

Question 4

Question 3

Audit Approach

Question 2

Question 1



Audit Metrics

Scenario

Question 1 – Estimation uncertainty

Which of the following inputs used in the valuation of the biological assets do you think has the highest level of estimation uncertainty?

- A Yields
- B Selling price
- C Costs to sell
- D All the above

Question 4

Question 3

Audit Approach

Question 2

?

Question 1

Audit Metrics

Scenario

Question 2

In one or two words, please describe the grow conditions that you think has the greatest impact on the yield estimates used in the fair value of biological assets?

- Question 4
- Question 3
- Audit Approach

- Question 2
- Question 1
- Audit Metrics
- Scenario

Audit Approach

The audit team identified the following **significant risk: Valuation of Biological Assets – Estimates**

The audit team performed the following procedures:

- 1 Agreed the total items **counted** to the biological assets' **valuation model** and **investigated variances +/-10%**.
- 2 Completed the **C-PEG inventory checklist** for the biological asset count at the year-end.
- 3 Developed a **point estimate** for yields based on the mid-point of the low- and high-end range of the actual yields from the last 2 years historical data obtained from its **US operations**.
- 4 Compared the **point estimate** for the yield inputs to disclosures from a sample of **10 public company** financial statements in the cannabis sector.

Question 4

Question 3



Audit Approach

Question 2

Question 1

Audit Metrics

Scenario

Question 3

Based on the procedures described, has the auditor adequately addressed the effects of estimation uncertainty of yields on the fair value model for biological assets?

- A** Adequate procedures are performed using the historical data and comparing to publicly available data.
- B** The procedures appear adequate given the industry and lack of reliable data that is available.
- C** The audit team has not adequately addressed the level of estimation uncertainty as it relates to the grow conditions.
- D** Grow conditions and/or other factors do not significantly impact the yields and therefore, yields would not have a high level of estimation uncertainty.



Question 4

The audit team counted biological assets using an inventory checklist from a prior year audit file in the retail industry. Which other considerations should be made to tailor the checklist?

- A Licensed grow area.
- B Licensed facility.
- C Interview with the responsible person in charge and review of regulatory filings.
- D All the above.



CPAB Inspections Forum: Cannabis

Poll questions answers

5

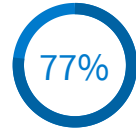
Activities

18

Participants

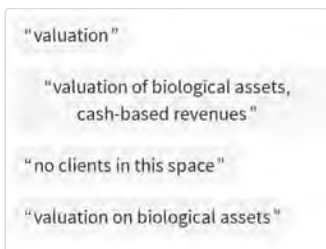
19

Average responses

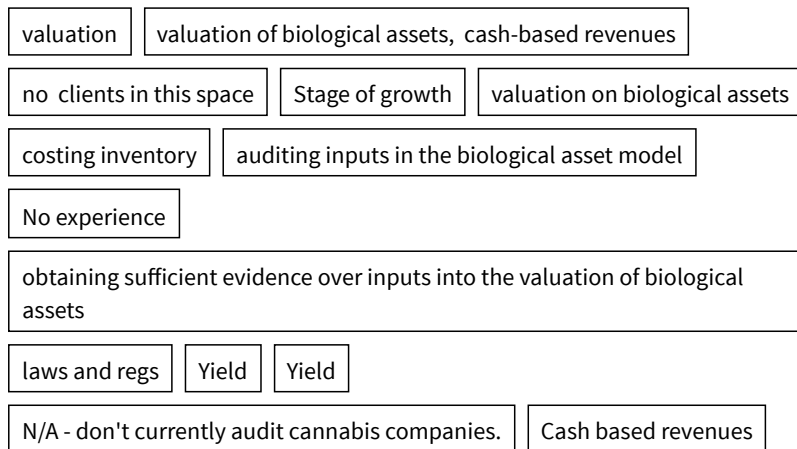


Average engagement

What are some of the challenging areas you have experienced when auditing cannabis companies?



Responses



Engagement

14

Responses

Which of the following inputs used in the valuation of the biological assets do you think has the highest level of estimation uncertainty?



Response options

Yields

Selling Price

Costs to sell

All the above

Count Percentage

10 34%

3 10%

0 0%

16 55%



Engagement

29

Responses

In one or two words, please describe the grow conditions that you think has the greatest impact on the yield estimates used in the fair value of biological assets ?

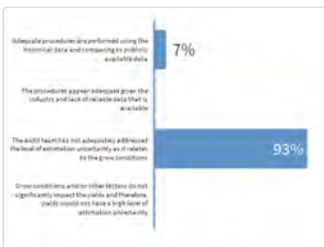


Responses

no clients in this space	Indoor outdoor	Light	Indoor outdoor
indoor vs outdoor	strain	Location (indoor vs outdoor)	Greenhouse
Light	greenhouse vs. outdoor	Indoor vs outdoor	
outdoor / temperatures			

50%
Engagement
12
Responses

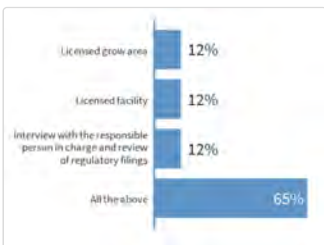
Based on the procedures described, has the auditor adequately addressed the effects of estimation uncertainty of yields on the fair value model for biological assets?



Response options	Count	Percentage
Adequate procedures are performed using the historical data and comparing to publicly available data	1	7%
The procedures appear adequate given the industry and lack of reliable data that is available	0	0%
The audit team has not adequately addressed the level of estimation uncertainty as it relates to the grow conditions	13	93%
Grow conditions and/or other factors do not significantly impact the yields and therefore, yields would not have a high level of estimation uncertainty	0	0%

72%
Engagement
14
Responses

The audit team counted biological assets using an inventory checklist from a prior year audit file in the retail industry. Which other considerations should be made to tailor the checklist?



Response options	Count	Percentage
Licensed grow area	3	12%
Licensed facility	3	12%
Interview with the responsible person in charge and review of regulatory filings	3	12%
All the above	17	65%

94%
Engagement
26
Responses

Auditing in the current environment



Accessibility



Quality of evidence



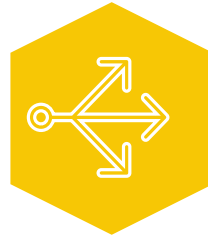
Going Concern

Key takeaways – Cannabis



Understanding the entity's operations

Laws and regulations and internal controls



What could go wrong?

Relate and map identified risk to what could go wrong



Risk assessment: Assertions

Granular risk assessment at the assertion level to build an effective audit approach

Questions



A sunset over a body of water with a blue geometric overlay on the left side. The sky is filled with soft, wispy clouds in shades of orange, yellow, and blue. The sun is low on the horizon, creating a bright orange glow that reflects on the water. In the distance, a city skyline is visible on the right side of the horizon. The left side of the image is dominated by a large, dark blue geometric shape that tapers to a point on the right, where it meets the sunset scene.

Closing remarks

Additional information



Useful links included in the pre-read materials



E-mail us at
cpabinspectionsforum@cpab-ccrc.ca



Thank You