



OIL & GAS

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CPAB Industry Forum Highlights Oil and Gas

CPAB's Oil and Gas Industry Forum was held on September 20, 2017 in Calgary for audit committee chairs of Canadian oil & gas companies.

Co-hosted by **Art Korpach**, audit committee chair, the Forum featured roundtable discussions about matters that are top of mind for audit committees of Canadian oil and gas companies.

The Forum featured current and emerging Canadian and international developments in audit quality and audit partner perspectives from **Leontine Atkins**, audit partner at KPMG.

Issues facing audit committees of oil and gas companies in Canada

Key Performance Indicators (KPIs)

Investors rely on KPIs, including non-GAAP measures, reported by oil and gas companies to inform their investment decisions. Despite industry efforts to standardize definitions of commonly disclosed KPIs, differences remain in how the KPI definitions are interpreted across the industry.

Participants noted that the proliferation of KPI reporting is a response to investor demand for additional insights into company performance – they say traditional IFRS financial statements do not provide a complete picture of a company's performance. However, participants also acknowledged that disclosures could be improved in how reported KPIs are aligned with a company's strategy and used to compensate management and, whether KPI definitions have changed period over period, and reasons for the change.

Audit committees should ensure that KPIs are subject to robust disclosure controls and procedures. Participants also discussed the need for auditor assurance over KPIs and non-GAAP measures and if stakeholders would find this valuable. The general consensus was that this warrants further consideration by various stakeholders.

Enterprise risk management including cybersecurity

Participants said some of their boards allocate risk oversight to committees in several areas. These committees are responsible for deeper dives that evaluate the soundness of

risk management processes implemented by management. Cybersecurity remains an area of focus for audit committees of oil and gas companies. Participants agreed that oversight of cybersecurity risk management should not be limited to audit committees but should be under the direct purview of the entire board of directors.

Climate change reporting

Participants noted the increasing focus on climate change reporting could have a significant impact on many industries, including oil and gas. Areas of concern include the difficulty in quantifying some of the disclosures and potential lack of comparability among companies in the same industry. This is an area that will see more focus by securities regulators and will be an area of interest for directors and audit committee members going forward.

International exposure to resource security and tax policy

Tax policy is top of mind for audit committees. Cross-border transactions within a multinational company create significant complexity and risks as tax agencies have been more active in opposing transfer pricing strategies they regard as artificial. Recent disputes between the Canada Revenue Agency and a high profile Canadian resource company highlight the importance of audit committee oversight of a company's tax policy, including oversight of processes and controls over cross-border transactions and transfer pricing policies.

Developments in audit quality

CPAB overview

- CPAB has a risk-based file selection process focused on industry and reporting issuer risks.
- Continued need for audit firms to improve consistency of execution as many files show a high level of audit quality but others require significant improvement.
- Audit firms provide CPAB's significant inspection findings in writing to audit committees under the Protocol for Sharing Inspection Findings with Audit Committees (Protocol).
- CPAB seeks to increase awareness of audit quality matters among audit committees through 1:1 meetings and presentations and publications that assist them in their oversight role.

Relevance of the audit

- The focus of investors and equity analysts on other information outside of the financial statements (i.e., KPIs including non-GAAP measures) raises questions about the relevance of the audited historical financial information.
- CPAB held an Audit Quality Symposium in May 2017 to further explore this matter. Three key messages emerged:
 - The belief of stakeholders that all information disclosed by reporting issuers is equally reliable represents an expectations gap that creates a risk to the capital markets.
 - Auditors and audit committees have an opportunity to engage increasingly with information outside the financial statements to enhance its reliability and reduce the expectations gap.
 - Transformational change is required to ensure there is continued confidence in the information that drives the capital markets and the audit remains relevant.

Audit Quality Indicators (AQIs)

- Use of AQIs can positively impact audit quality.
- CPAB sponsored a pilot project in 2016 with audit committees of six public companies to explore the usefulness of applying an AQI framework.
- No predefined set of AQIs was prescribed; pilot participants selected AQIs based on specific circumstances and areas of focus; significant variation in AQIs was observed across pilot participants. Context is important in understanding and use of AQIs.
- Participants commented that the greatest benefit of an AQI framework was the dialogue it encouraged among audit committees, audit firms and management.
- AQI pilot is continuing in 2017 with 19 participants.

Expanded auditor reporting

- Expanded auditor reporting under the International Standards on Auditing include a requirement for auditors to describe **key audit matters** (KAMs) that were of most significance in the audit.
- The PCAOB's expanded auditor reporting standard, approved by the SEC on October 13, 2017, requires the reporting of **critical audit matters** in the US for calendar-year large accelerated filers for audits of 2019 financial statements and 2020 financial statements for all other calendar-year companies.
- In Canada, the Auditing and Assurance Standards Board's (AASB) new auditor reporting standards currently treat the reporting of KAMs as voluntary unless required by law or regulation. This may be reconsidered by the AASB given the change in the US now that the SEC has approved the PCAOB's auditor reporting standard.
- Audit committees in Canada are encouraged to discuss the impact of expanded auditor reporting with their auditors.

¹ A summary of the Audit Quality Symposium: *Earning Investor Confidence* is available on CPAB's website.

Audit partner perspectives on areas of audit focus

Key areas include:

- **Impairment (and impairment reversals) of oil and gas assets** with a focus on:
 - Key inputs and assumptions used by management in its valuation techniques.
 - What oversight the company exercises over the reported reserves (i.e., board sub-committee, and/or external audits).
- **Group audits**
 - Challenges for group auditors when relying on work done by component auditors in foreign jurisdictions.
 - Understanding business practices, legal structures, customs and cultural norms in foreign jurisdictions.
- **Tax balances**
 - Auditors typically engage internal tax specialists given the complexity arising from understanding foreign tax regimes, transfer pricing and the impact of foreign currency on tax balances.
- **Focus on internal controls and strength of corporate governance**
 - Working with the board committee responsible for reserves and resources (see above).
- **Implementation of new accounting standards**
 - Oil and gas companies will need to change certain revenue recognition and lease accounting practices when implementing IFRS 15, *Revenue from contracts with customers* and IFRS 16, *Leases*. These new accounting standards issued by the International Accounting Standards Board are effective for fiscal years starting on or after January 1, 2018 and 2019, respectively.

Thank You

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

Learn More

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www.cpab-ccrc.ca / Email: info@cpab-ccrc.ca

