MINING

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CPAB Industry Forum Highlights Mining

CPAB held Mining Industry Forums on October 3, 2017 in Toronto and October 5, 2017 in Vancouver for audit committee chairs of Canadian mining companies.

Co-hosted in Toronto by **John Clappison**, audit committee chair of Cameco Corporation and Rogers Communications Inc., and in Vancouver by **Dale Peniuk**, audit committee chair of Lundin Mining Corporation, Capstone Mining Corp. and Argonaut Gold Inc., the Forums featured roundtable discussions about matters that are top of mind for audit committees of Canadian mining companies.

The Forums included discussions about current and emerging Canadian and international developments in audit quality, and audit partner perspectives from **Lee Hodgkinson**, audit partner and National Mining Industry Leader at KPMG, in Toronto and **Craig McMillan**, audit partner at PwC, in Vancouver.

Issues facing audit committees of mining companies in Canada

The mandate of audit committees continues to evolve. Beyond the traditional oversight role over the financial reporting process and the work of the auditor, boards are increasingly asking audit committees to oversee more strategic areas of the mining business.

Enterprise risk management including cybersecurity

Participants described practices at their companies where 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 mining companies. A recent data breach at a leading Canadian mining company has prompted several mining companies in Canada to pool resources in a newly formed body called the Mining and Metals Information and Sharing Analysis Centre (MM-ISAC). MM-ISAC's purpose is to explore collaborative solutions to cybersecurity threats affecting the industry. 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.

International exposure to resource security and tax policy

The mining industry is particularly susceptible to geopolitical risks. Mining projects in emerging markets are often flash points for nationalist debate given their significance to local economies. For mining companies with global operations, resource security risk is a key area of focus for audit committees and boards.

Tax policy is another area that 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. A recent dispute between the Canada Revenue Agency and a high profile Canadian mining company highlights 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.

Low for long commodity price implications

With some commodity prices expected to remain depressed for the foreseeable future, mining companies have transformed their businesses in innovative ways to navigate the new normal. Cost containment is a common strategy in this environment but participants noted this creates challenges for audit committees as they consider the following:

- Impact of leaner staffing on quality control systems.
- Relative merits of co-sourcing vs. in-sourcing of internal audit function in terms of cost and access to skilled staff.
- Attracting and retaining the best and brightest.

Compliance matters

Compliance with the requirements of the Extractive Sector Transparency Measures Act (ESTMA) and the Corruption of Foreign Public Officials Act (CFPOA) for mining companies listed in Canada, and the Foreign Corrupt Practices Act (FCPA) for dual-listed mining companies listed on US exchanges is high on the agendas of boards and audit committees.

The ESTMA rules are complex and directors and officers could be held personally liable in the event of non-compliance. Participants discussed the relative roles of management, the audit committee, and the external auditor under the ESTMA disclosure requirements. Also discussed was the repeal of similar SEC disclosure requirements in the US (Exchange Act Rule 13q-1) in February 2017 and implications for audit committees of Canadian dual-listed mining companies.

Key Performance Indicators (KPIs)

Investors rely on KPIs, including non-GAAP measures, reported by mining 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 by companies in the industry.

Participants noted that the proliferation of KPI reporting responds to a demand by investors for better insights into company performance. However, participants also acknowledged that disclosures could be improved in (i) how reported KPIs are aligned with a company's strategy and used to compensate management, and (ii) whether KPIs definitions have changed period over period and the reasons for the change. Audit committees should ensure that KPIs are subject to robust disclosure controls and procedures.

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 one-on-one 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.

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

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 KAMs as voluntary unless reporting is required by law or regulation. The voluntary reporting of KAMs may be reconsidered by the AASB 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.

Audit partner perspectives on areas of audit focus

Key areas include:

- **Impairment (and impairment reversals) of mineral properties** with a focus on:
  - Key inputs and assumptions used by management in its valuation techniques.
  - Whether the qualified professional engaged by management for the NI 43-101 report is internal or external to the company, and what oversight the company exercises over the reported reserves (i.e., board sub-committee, and/or external audits).
  - Timeliness of the release of NI 43-101 reports and the resulting implications for the audit.
- **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**
  - Skills and knowledge of internal auditors that can be leveraged in the audit.
  - Working with the board committee responsible for mineral reserves and resources (see above).
- **Asset retirement obligations**
  - Key inputs and assumptions used by management in its measurement techniques, including appropriateness of discount rates.
- **Implementation of new accounting standards**
  - Mining 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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