Communicating Key Audit Matters: A Post-Implementation Review

Executive Summary

This report summarizes the results of a post implementation review of the implementation of Key Audit Matters (KAMs) in the Canadian market for entities with yearends beginning after December 15, 2020. KAM data was collected using the Audit Analytics database and interviews were conducted with stakeholders including auditors, audit committee members, preparers, and sophisticated users. In all, the data set consisted of 618 enhanced audit reports encompassing 895 KAMs and 38 hour-long stakeholder interviews conducted between March and July 2022.

The study shows that a distinctive Canadian KAMs reporting practice has developed since the enhanced audit reporting standards became effective. This practice is characterized by a low average number of KAMs per audit report (1.55) compared to other jurisdictions that require KAMs reporting. Fewer than 5% of audit reports have zero KAMs. Zero KAM reports involve extensive consultations across audit firms, as practitioners weigh the pros and cons of reporting a zero KAM report versus reporting one that is of limited value to users.

The Canadian KAMs reporting practice is virtually universal in opting not to include outcomes or observations. Interview data suggests that the Canadian legal and regulatory environment had an important influence, with auditors hesitant to go beyond the requirements of the standard because of possible legal exposure. The result is a KAM with tight, rigorous wording. Many interviewees mentioned aligning with the Critical Audit Matter practices used by their US counterparts.

Textual analysis of the KAM passages across the data set suggests that Canadian auditors are customizing their KAM descriptions and responses to the particular circumstances of their clients. In contrast, KAMs reported for the same entity on the same issue in successive years are much less textually diverse. In most cases, the text includes few if any changes because the conditions that drove the KAM reporting in the first year persist. Although this practice could result in an atrophy to boilerplate, leading to diminished usefulness of the reports, consistency in the year-over-year wording was also viewed as logical and inevitable when conditions are unchanged.

Our interviews indicate that the training and support for the KAMs implementation served well: significant time and effort was required by engagement and professional practice staff but the implementation proceeded according to expectations, with financial reporting process stakeholders (auditors, preparers, audit committee members) consistently reporting “no surprises” and few areas of sensitivity.

Users reported limited awareness of the existence of KAMs, and very limited use of the information. Even after reviewing example KAMs, users indicated that they were unlikely to use the information. Given the barrage of information, users viewed the KAMs as dated and not sufficiently informative about the business and/or business model.

The KAMs practice developed for entities listed on the Toronto Stock Exchange (TSX) can provide helpful guidance for the upcoming TSX-Venture Exchange (TSX-V) implementation. However, the less mature governance structures within many TSX-V-listed entities could pose challenges to a smooth KAMs implementation. Auditors are best placed to mitigate these challenges through education and engagement with preparers and audit committee members.

The report that follows is organized as follows:

- Introduction and background
- Population data and preliminary observations
- Communicative value and transparency of KAMs
- A closer look at the Canadian implementation
- The users' experience
- Impact on the next wave (thoughts on the upcoming implementation of KAMs for TSX-V entities)

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1 Introduction and Background

While the pass-fail model of the audit report had the benefit of being brief, clear, and consistent, many stakeholders have claimed that it was of limited use to those who wanted a more detailed understanding of the audit findings and the audit process. The introduction of key audit matters (KAMs) is meant to address this gap by providing more useful information to investors (IAASB, 2011). As David Tweedie, the former chair of the International Accounting Standards Board (IASB) and national technical director for KPMG, explained, “Investors should get insight into what kept the auditor awake at night, what arguments the auditor had with the CFO, what the big estimates are, what the contentious accounting policies are, and what are the going concern assumptions.”

Canada is one of the later adopters of KAMs — far behind the early adopters, such as the United Kingdom and the Netherlands, and the majority of countries that adopted KAMs for the first time in 2016. Canada is also behind the United States, which implemented critical audit matters (CAMs) in 2019. With the companies listed on the Toronto Stock Exchange (TSX) having implemented KAMs over a year ago, and with the next wave — the TSX Venture Exchange (TSX Venture) — coming into effect for 2022, it is timely to examine the experience of the TSX-listed companies. This report examines the *what*, *why*, and *how* of Canadian KAM reporting:

- **what**: an overview of the Canadian KAM reporting landscape
- **how**: an examination of how KAMs were implemented
- **why**: an explanation of why KAMs reports have developed in a particular way

We will address the following questions:

1. What is the communicative value of KAMs? In particular, to what extent do we observe the use of overly technical jargon, lack of specificity, and/or boilerplate language?

2. What is the level of diversity of KAMs within industries and among auditors?

3. How do **auditors** describe the KAM reporting process? What were the benefits and challenges within the process? Have KAMs impacted the quality of financial reporting and/or audits?

4. How do **audit committee members** describe the KAM reporting process? What were the benefits and challenges within the process? Have KAMs impacted the quality of financial reporting and/or audits?

5. How do **preparers** describe the discussion process that led to the communication of KAMs in the audit report? Have KAMs impacted the quality of financial reporting and/or audits?

6. How has KAM reporting impacted **investors’** decision-making?

In order to examine the *what* and *why* of the state of KAM reporting and *how* stakeholders experience KAM reporting, we employ a mixed-methods approach. The quantitative findings of this report are based on the analysis of 618 audit reports, which we describe in the next section. We include in that section our observations on the number of KAMs and the nature of audit matters and the further disaggregation of industries and audit firms.

We then dig deeper and perform textual analysis to assess the communicative value of KAMs. Whenever possible, to provide some comparability, we benchmark our findings against other jurisdictions – mostly the United Kingdom and the United States. To help explain the current state of KAMs reporting (the how and the why), we supplement our quantitative analysis with 26 interviews with auditors, including professional practice and engagement partners, audit committee members, and preparers. Finally, since KAMs are meant to provide additional insights to investors, we report what 10 sophisticated users have to say about their perceptions of the usefulness of KAMs within financial reporting.

To assist the Auditing and Assurance Standards Board (AASB) in developing additional guidance to support auditors and other stakeholders who will be reporting KAMs in 2022, we asked stakeholders for their views on what's working and what's not and how the KAM reporting process, as well as the KAMs themselves, could be improved. We hope these key takeaways will provide valuable guidance to all stakeholders, including the AASB.

2 Population and Preliminary Observations

This report takes into account the audit reports issued for 618 TSX-listed companies. These audit reports represent all TSX-listed companies with yearends between December 15, 2020, and December 14, 2021, that were required to report KAMs[1] under Canadian Generally Accepted Auditing Standards (GAAS). In total, the audit reports, which were provided by 32 different audit firms,[2] generated 895 KAMs. Of the total, 20 reported zero KAMs.

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

2.1 Home Country of Statutory Auditor

Figure 2.1 shows that of the 618 audit reports filed:

- Canadian auditors filed 543 (88%) audit reports; and
- Australian and UK auditors filed most of the remaining 75 audit reports (12%).

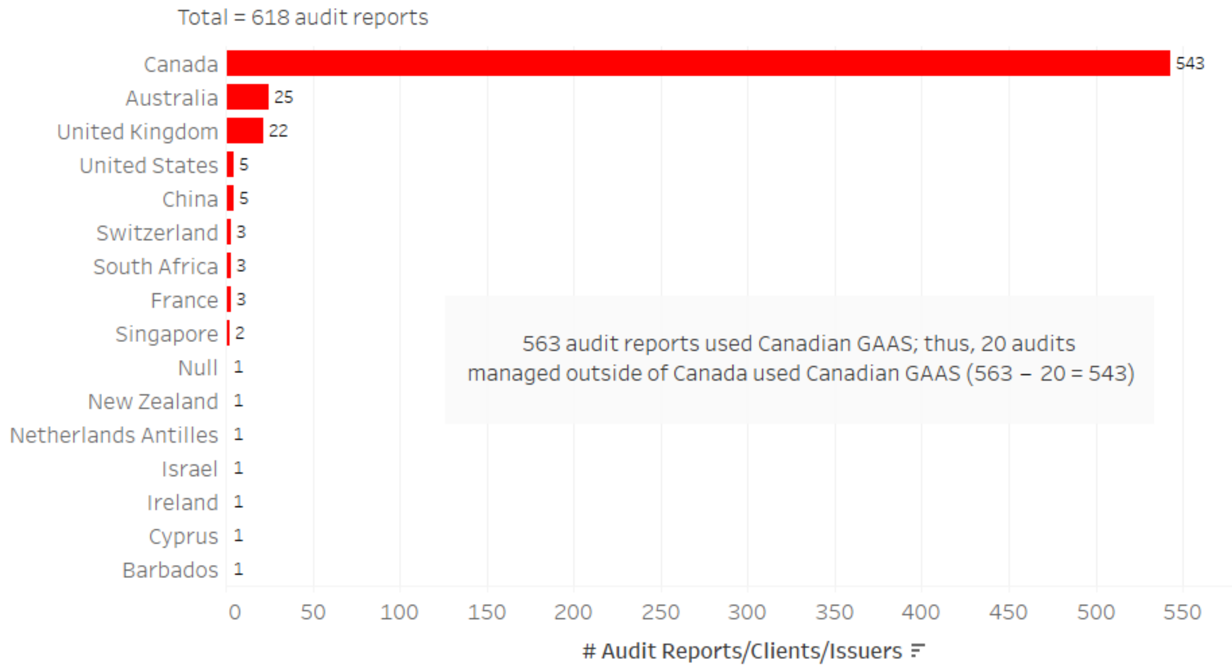
Nineteen of the international reports referred to Canadian GAAS, while the remaining 55 referred to International Standards on Auditing (ISA) or one of its versions — that is, ISA (UK), ISA (Ireland), or the Australian Auditing Standards (AAS).

Our analysis focuses on the 543 Canadian audit reports; however, we refer to some of the remaining 75 audit reports when providing examples of the different approaches taken by the international auditors.

[1] The yearends ranged from December 25, 2020, to November 30, 2021.

[2] Firms networked across provinces and/or countries counted as one firm.

Figure 2.1: Audit Office Location by Country



2.2 Average Number of Key Audit Matters

The average number of KAMs in the total observed population was 1.55 per audit report. This figure is based on all the entities for which enhanced audit reporting was used in the Canadian market. Most entities are TSX listed, with some on the TSX V and Canadian National Stock Exchanges. These entities are audited by a mix of international auditors and those based in Canada. The definition of KAMs for this figure includes the going concern section reported outside the KAM section of the audit report on the assumption that comparative figures from other markets (as listed in Figure 2.2) includes them.

After removing the international auditor reports, the average number of KAMs reported in the Canadian market is 1.45 per audit report across the 543 audit reports[3] issued by auditors based in Canada. This figure is significantly lower than the averages reported for the United Kingdom and Australia and slightly lower than the average reported for the United States, as shown in Figure 2.2.

[3] The average number of KAMs per audit report for international auditors (that is, excluding audit reports issued by auditors based in Canada) in our population is 2.11.

Figure 2.2: KAMs Reported Across Different Markets

	Average # of KAMs per report	KAMs adoption date: FYEs† after	FYEs represented	Sample description	Source
Australia	2.01	Dec 15, 2016	2017–2018	1,695 audit reports	Kend & Nguyen, 2020
United Kingdom	4.52	Sep 30, 2013	2013–2016	FTSE 100 only	Sierra-Garcia et al., 2019
	3.27		2013–2019	LSE premium non-financial	Deneuve et al., 2022
	4.2		unclear	560 audit reports	Gambier, 2018
US	1.7	Jun 30, 2019	2019–2020	1,400+ large accelerated filers	PCAOB, 2020
Canada	**1.55**	Dec 15, 2020	Dec 25, 2020 – Nov 30, 2021	Primarily TSX-listed, 618 reporting entities	
	1.45			543 reporting entities; auditors based in Canada only	

†FYE = fiscal yearends; FTSE: Financial Times Stock Exchange; LSE: London Stock Exchange

However, the United Kingdom is considered to be an outlier. In the first year, many UK reports included these two mandated risks:

- fraud in revenue recognition

- management override of controls

In the second year of implementation, the Financial Reporting Council (FRC) advised "management override of controls" should not be a KAM if it is not meaningful information. Although the number of KAMs related to those two risks have declined since then, the UK average is still higher than other countries (Gambier, 2018). The Canadian average is closer to the average number of CAMs for US companies in the first year of implementation, which was 1.7 CAMs (PCAOB, 2020).

From our interviews (See Appendix B – Participant Profiles for details on respondents), there is a consensus among auditors that the implementation of CAMs in the United States has clearly influenced the implementation, including the number reported, of Canadian KAMs. However, despite that influence, Canada has followed a slightly different path. As explained by an audit partner who has clients for which CAMs and KAMs are reported:

> Typically, you know, what you see there (referring to US professional practice) is they are trying to get to at least one CAM. Here I've seen a little bit more "you can live with no KAM," you know, if it's appropriate.
>
> -audit partner, Big Four firm

Given the Public Company Accounting Oversight Board (PCAOB) (2019) has stated that it expects at least one CAM, it is understandable why the United States has a higher average. However, as we will discuss later in the report, despite Canadian auditors being able to "live with no KAM," these situations are closely scrutinized.

2.3 Number of KAMs by Sector

The number of KAMs varied by sector. The financial services and mining sectors had the highest average number of KAMs. However, the higher average for the mining sector is partly due to the higher number of KAMs reported by international auditors, which make up 34% of the total audits. The international auditor average (2.02) is lower than the average reported for the mining sector in the European Union (2.6) but higher than the average for the mining sector in the United States (1.8).

Comparing to other jurisdictions, the industries with the highest number of KAMs are:

- mining — United States: 1.8; European Union: 2.6; and
- retail — United Kingdom: 4.4 (PwC Canada, 2021).

Figure 2.3: Average Number of KAMs per Audit Report by Sector

Sector	Average # KAMs per audit report by sector Split by audit office location			# Audits performed		
	Canada	Other country	All locations	Canada	Other country	Total
Financial Services	1.64	2.20	**1.66**	108	5	113
Consumer	1.43	4.00	**1.52**	54	2	56
Life Sciences	1.27	3.00	**1.47**	15	2	17
Mining	1.17	2.02	**1.45**	94	45	139
Oil & Gas	1.23	2.55	**1.43**	61	11	72
Communications & Media	1.32	4.00	**1.42**	25	1	26
Utilities & Pipelines	1.44	1.00	**1.39**	16	2	18
Industrial	1.37	1.50	**1.37**	97	2	99
Technology	1.26	1.00	**1.22**	31	5	36
Real Estate	1.19		**1.19**	42		42
Grand Total	**1.36**	**2.11**	**1.45**	**543**	**75**	**618**

The remainder of this report focuses on reports issued by auditors based in Canada. Further, **going concern** sections, which were counted as KAMs in the section 2.2 analysis above, are excluded. The number of KAMs reported on this basis is 1.36 per audit report across the 543 audit reports.

2.4 Types of KAMs by Topic

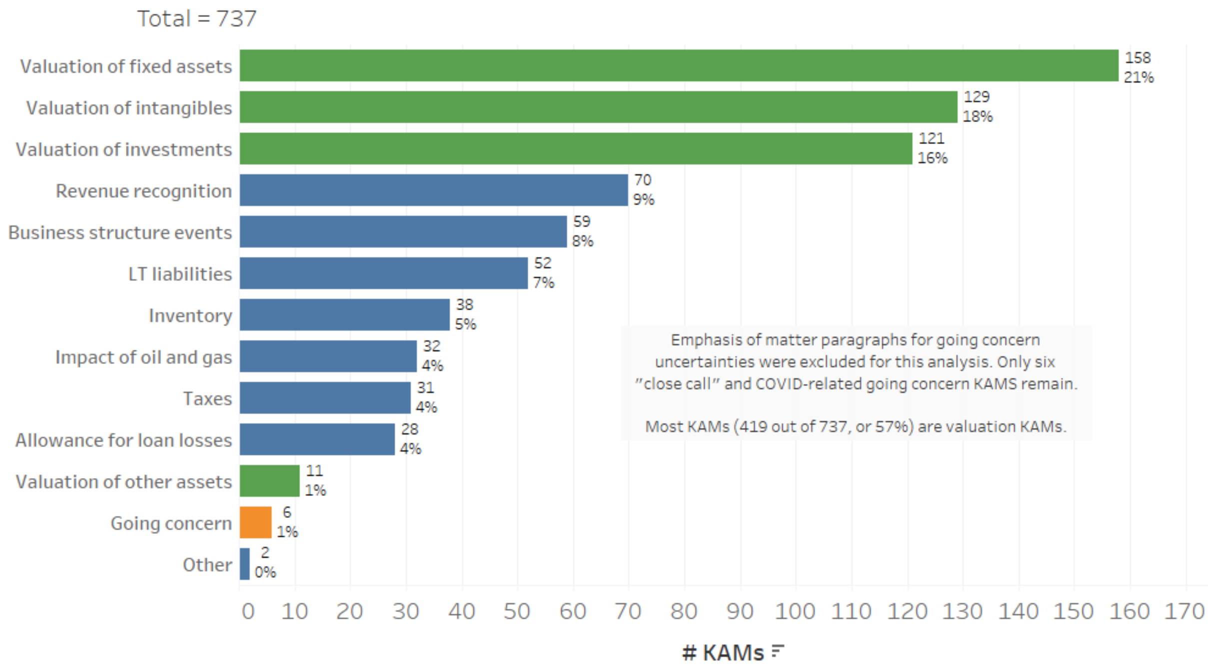
In total there were 737 KAMs reported across the 543 audit reports issued by auditors based in Canada. The most common topics were related to different types of asset valuation:

- Valuation of fixed assets
- Valuation of intangibles
- Valuation of investments
- Valuation of other assets

This is not surprising since these assets are often critical areas of management judgment and have material carrying values that would have the greatest impact on the overall audit strategy and resources required. In the United States, 35% of KAMs are related to goodwill and other intangibles, whereas in Canada it is only 18%. In the United Kingdom, 10% are related to goodwill and 13% are related to impairment of assets (PwC Singapore, 2017).

Following valuation of assets, revenue recognition is the most common KAM. The average (9%) is much lower than those reported in the United States (25%) and the UK (16%) (PCAOB, 2020; FRC, 2016). However, since half of the UK revenue KAMs are related to fraud, the number of Canadian KAMs is close to the number reported in the United Kingdom. (PCAOB, 2020; FRC, 2016).

Figure 2.4: KAMs by Topic



The Canadian KAMs database showed that only 6 out of 737 KAMs (0.8%) — or 6 out of 543 audit reports (1%) — authored by auditors based in Canada were close call or COVID-related going concern KAMs. By contrast, 9 out of 158 KAMs (6%) — or 9 out of 75 audit reports (12%) — authored by international auditors reporting into Canadian markets were close call or COVID related. Additionally, a 2021 FRC publication showed that audit reports for 5% of FTSE 150 entities and 15% of FTSE 250 entities included a close call KAM.

2.5 Types of KAMs by Sector

Figure 2.5 shows the breakdown of KAM topics by the various sectors. The distribution of KAMs appear to reflect the nature of the risks in each sector. For example, the top three KAMs for financial services are valuation of investments, intangibles, and loan losses.

Figure 2.5: KAM Topics Across Sectors

KAM Topics across Sectors

	Comm & Media	Consumer	Financial Services	Industrial	Life sciences	Mining	Oil & gas	Real estate	Tech nology	Utilities	Grand Total
Allowance for loan losses		3	24				1				**28**
Business structure events	6	8	15	9	2	7	4	3	1	4	**59**
Going Concern	1	2	1			1		1			**6**
Impact of oil and gas			1	1		13	17				**32**
Inventory		9	4	14	1	5		3	2		**38**
Long-term liabilities		2	22	12	1	9		2	2	2	**52**
Other						1			1		**2**
Revenue recognition	7	7	8	23	1	3	1	4	14	2	**70**
Taxes	1	2	10	7	1	4	3		2	1	**31**
Valuation of fixed assets	4	19	7	25	2	49	41	1	5	5	**158**
Valuation of intangibles	13	22	31	32	7	6	5	3	6	4	**129**
Valuation of investments	1	3	53	8	4	9	2	32	4	5	**121**
Valuation of other assets		1	1	2		3	1	1	2		**11**
Grand Total	**33**	**78**	**177**	**133**	**19**	**110**	**75**	**50**	**39**	**23**	**737**

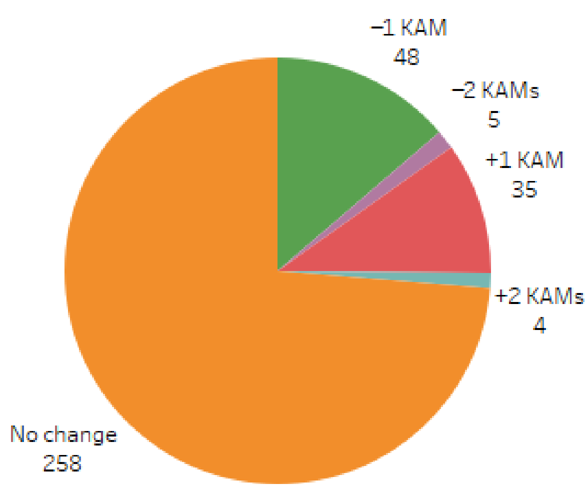
Note: The darker the cell, the greater the number of KAMs for that particular topic.

2.6 Number of KAMs reported in second year

Figure 2.6 shows a year-over-year comparison of the number of KAMs issued for the same issuer in the second year of implementation compared to the first. The figure is based on second-year KAMs that were entered into the Audit Analytics database by mid-April 2022, which represent approximately 57% (350 out of 618) of the entities for which KAMs were reported in the first year of implementation. Given the timing, only entities with December 2021 and January 2022 yearends are included.

Figure 2.6: Change in Number of KAMs Reported

Second year of KAMs implementation versus first year



Although most of the audit reports (258 out of 350, or 74%) are reporting the same number of KAMs in the second year compared to the first, there is some variability in the number of KAMs reporting. This is to be expected given that some KAMs are related to in-year transactions that are not expected to recur on a regular basis.

Overall, it appears that KAM reporting norms, as they apply to the number of KAMs issued per audit report, are well established in the Canadian market.

2.7 Preliminary Observations

This overview of the KAM reporting landscape highlights that most audit reports for TSX-listed companies contain one or two KAMs. This average number is lower than that in the United States as well as other jurisdictions such as the United Kingdom and Australia. While some have suggested that auditors can and should say more about matters of most importance to the audit (Gambier, 2018), Canadian auditors are comfortable with reporting fewer KAMs and, as we will discuss, they firmly hold the view that "less is more."

Apart from benchmarking Canada with other jurisdictions, this overview may be helpful to auditors who are first-time adopters in the next wave, such as the TSX Venture group. While the number of KAMs and KAM topics should be based on the facts and circumstances of each company, information about KAMs across different sectors can serve as a benchmark for what is a reasonable number of KAMs within certain industries. However, consistency does not always translate into an audit report that is a relevant and useful source of information. In the next section, we examine the communicative value of KAMs.

3 Communicative Value and Transparency of KAMs

Historically, the audit report has been legalistic and boilerplate, without providing any meaningful insights to users. The inclusion of KAMs could enhance the communicative value of the audit report and make the audit process more transparent if the KAMs are understandable, insightful, relevant, and useful to the intended users. In its analysis of their members' experiences with the implementation of KAMs, the Institute of Chartered Accountants in England and Wales (ICAEW) provided the following advice:

- Avoid being too technical — don't use a lot of audit, accounting, or sector-specific terminology that users won't understand.
- Make KAMs specific to the entity.
- Be precise when describing risk responses.
- If findings or observations are included, be transparent about the rationale behind the end results.
- Make the report accessible and interesting – consider using charts to make the report more interesting and easier to read. (ICAEW, 2017)

3.1 Readability and Clarity

Our analysis of the communicative value of the KAMs starts with the readability measure called the Gunning fog index, which is used in the linguistics field.[4] As the name implies, the fog index measures how difficult text is to understand. A low fog score, which indicates more plain and simple language, suggests that the KAM is easy to understand and that it is not using too much technical language. Higher scores suggest the opposite: the reader must put in more effort to process and understand the information. (See Appendix C – Fog Scores Related to Various Financial Reports for a summary of fog scores for different types of financial reports.)

We limit our analysis of readability to the KAM description sections, which, because they are typically written in prose, can generate a meaningful fog score. In contrast, the risk response sections of most KAMs in our data set are presented as bulleted lists, which the textual analysis tool identifies as long, single sentences, and, as a result, calculates high fog scores. These poor readability scores are misleading since the bulleted list likely helps readers understand and increases the accessibility of the report. One of our users who represents one of the securities regulators and who had read several KAMs, explained: "This is just superficial, but what helped me was bullets versus, like, a long paragraph that I would get lost in."

Figure 3.1 shows the fog readability scores for the KAM descriptions, categorized into the eleven TSX industry sectors. The average fog score across all KAM descriptions was 22.49, which

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[4] Fog score = (average sentence length in words + % complex words x 100) × 0.4, where complex words have three or more syllables.

is much higher than the reading level for an average college graduate (readability score = 17). It is also higher than the average fog score of the 1,373 UK audit reports in 2021, which was 21.1 (Abdelfattah, Elmahgoub & Elamer, 2021).[5] Looking at fog scores based on KAM topic, we see that each topic score is above the readability level of the average college graduate; however, some topic scores — inventory and other — are lower than the UK audit reports.

Figure 3.1a: KAM Readability Scores by Sector

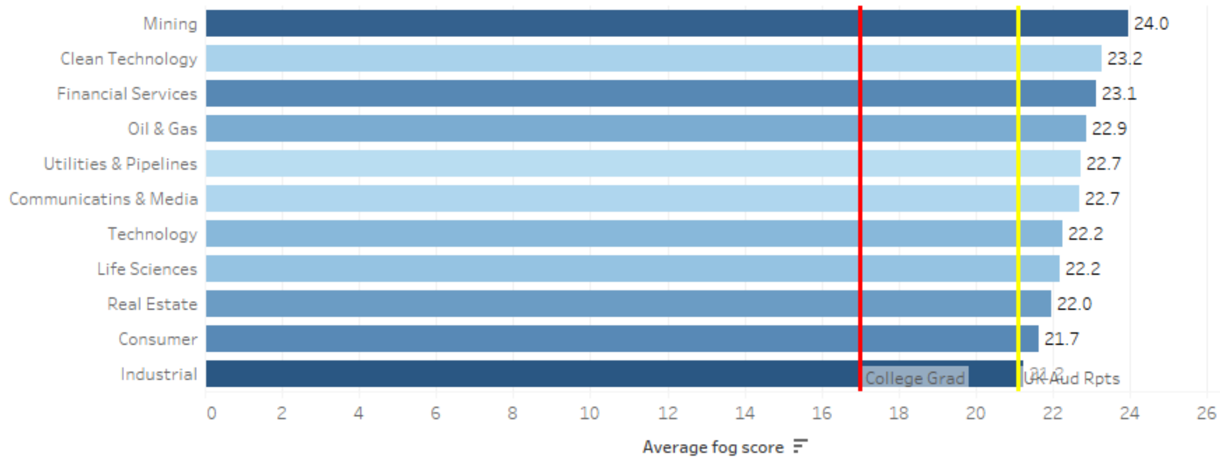
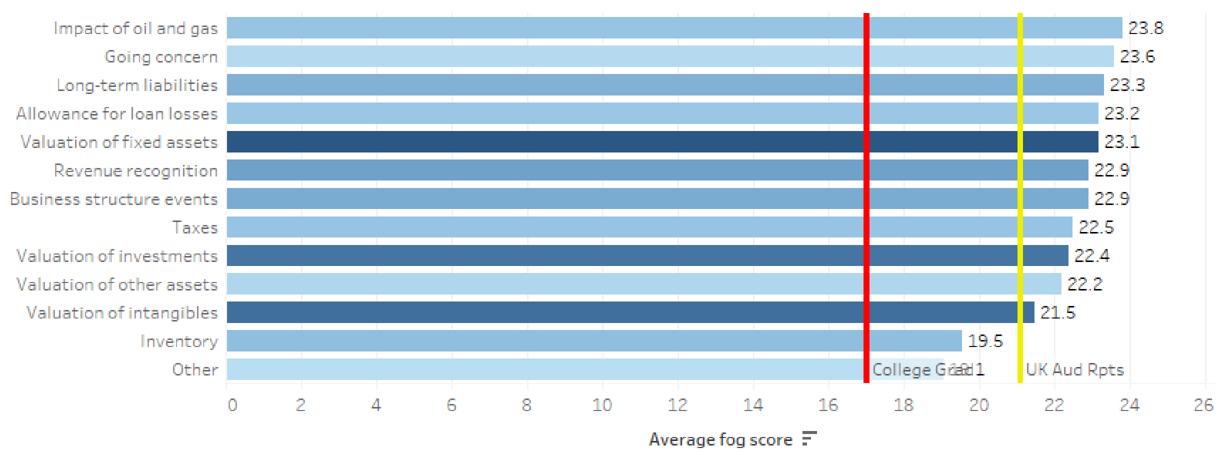


Figure 3.1b: KAM Readability Scores by Topic



Note: The intensity of the blue bars corresponds to the number of KAMs issued in each sector, with darker bars indicating more KAMs and lighter bars indicating fewer KAMs.

[5] In the UK study, the fog score is calculated for the entire audit report, not just the KAMs.

The word clouds in Figure 3.2 (the description section of the KAM) and Figure 3.3 (the response sections of the KAMs) provide a visualization of the common words being used in the various KAM topics. It does not appear that overly complex words are being used, and we do not see a high incidence of audit-, accounting-, or sector-specific terminology that users won't understand.

Based on our reading of several KAMs that had high, average, and low scores, it seems that long sentences, rather than complex words, are a key contributor to the high fog scores. (See Appendix C for some examples of KAMs with high, average, and low fog scores). It seems that the readability of Canadian KAMs could be improved by using shorter sentences and avoiding conditional sentences (those that include words such as "whether" or "not"), which tend to be more difficult to understand and are often misinterpreted.

Figure 3.1c: Word Clouds – KAM Description Sections by KAM Topic

Figure 3.1d: Word Clouds – KAM Response Sections by KAM Topic

The ICAEW, in its analysis of the UK implementation experience (ICAEW, 2017), advised auditors to keep in mind their audience — “people who may not be experts in accounting and auditing” (who likely have a reading level of the average college graduate). And the auditors aim to draft KAMs based on that level.

> …you want to write them in the way to make sure that they make sense to the average user. So that is the one thing that we talked about spending a lot of time on things is

> trying to make sure that the KAMs are understandable for an investor. We spent a lot of time on that.
>
> -professional practice senior manager, Big Four firm

Although auditors focus on the average user, as one audit partner explained, "I think in the KAMs there is an assumption that you've (the user) got some financial acumen that you could read." However, many auditors question which users would actually read and understand the audit report.

> Here's the challenge that I think that we have — and it goes not just for the audit report but for the full set of statements — How many investors, even analysts, are reading it cover to cover? How many people are reading the full audit report word for word every time? And trying to understand exactly what the auditors are doing? It is a small, small percentage of users I would say.
>
> -audit partner, Big Four firm

Despite attempting to make KAMs understandable to the average user, many auditors and former auditors (now audit committee members) discussed how KAMs are drafted with lawyers and regulators in mind, which ultimately influences the choice of words and presentation. As one retired audit partner, who now serves as audit committee chair, explained:

> I come from the [audit] industry. I had a lot of involvement with our professional practice, so I know how much these [KAMs] are scripted. I mean they [professional practice] go through these things with a fine-tooth comb, right? To make sure that all of this language there is no ability for anyone to then come back to the firms and say you should have said this, or you should have said that.
>
> -audit committee chair, former auditor at Big Four firm

Compared to the more detailed reports produced in the United Kingdom, which explored "what the audit committee members got from the auditors," Canadian KAMs are what one engagement partner describes as a "very tight and rigorous piece" — from an average of 504 words for oil and gas sector KAMs to 296 words for life sciences sector KAMs. Figure 3.4 breaks down the average word count by sector and KAM topic. All the auditors we interviewed reported that their firms considered what was happening in other jurisdictions, with most mentioning UK KAMs. However, the Canadian KAM practice that was developed emphasizes conciseness.

> …you look at a written K-KAM[6] from Canada and then you look at a written K-KAM from the UK — they look very different. The K-KAMs in the UK have a lot more detail; they talk a lot about findings and observations and not just conclusions, where, if you look at the community in the US, it is less information. Less is more. And I think that is more what it is. Like we are going to be really clear and concise on "here is what the account balance is, here is why we think it is a KAM, and here is what we did."
>
> I think it is market, the regulators, the investors in those two markets. I think that is what drove it.
>
> -professional practice senior manager, Big Four firm

This partner makes a similar observation regarding Canada following the United States and possibly sacrificing quality.

> I think by nature we did follow the US. And my interpretation is that the US, kind of, like, they are worried about the legal environment and everything like that. So, they are trying to keep it as bare bones as possible. And I think Canada had just followed suit. So, the quality of the KAMs probably is worse. But it is not surprising given how we got here.
>
> -partner, mid-tier firm

As one audit committee chair noted, UK auditors likely face less risk:

> …the UK legal system is quite a bit different. They don't have class action lawsuits to the same extent we have here. The more words you put out there in North America, the more places you have to hang from. And so, it is just built in.
>
> -audit committee chair; former auditor at Big Four firm

[6] This participant is referring to the common terms used in practice to clarify whether it is a KAM or the PCAOB equivalent of Critical Audit Matter (C-CAM).

Figure 3.1e: Average KAM Word Count by Sector

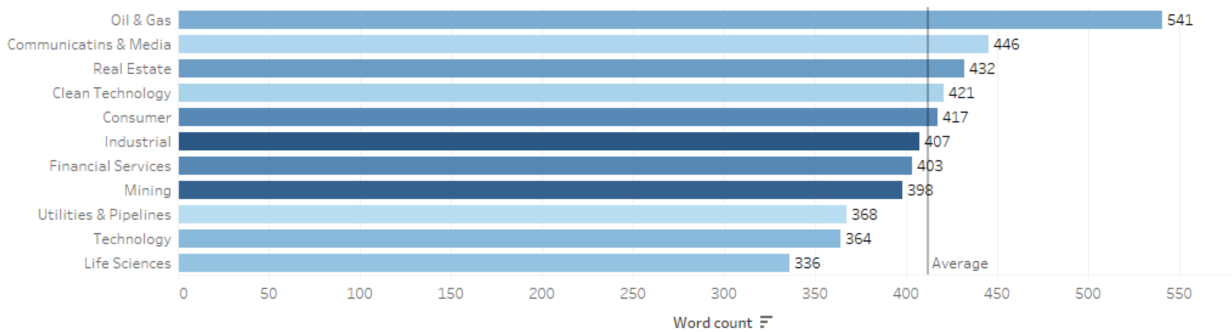
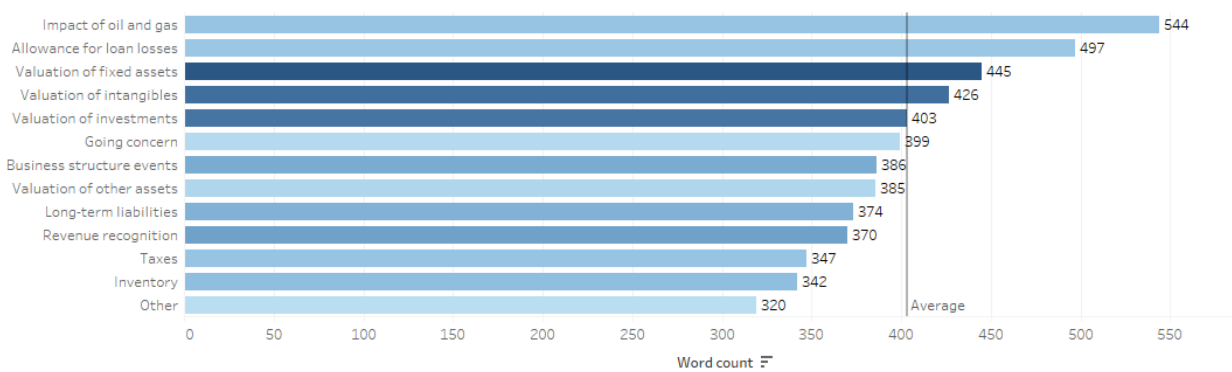


Figure 3.1f: Average KAM Word Count by Topic



3.2 KAMs Specificity versus Boilerplate

An important characteristic of an "informative" KAM is that it is specific to the entity. This user describes the features of an entity-specific KAM versus one that would be considered boilerplate:

> It is a judgment call. I think some of the things that we looked at are: Okay, is it just kind of repeating what is in the financial statement notes? Does it just say this is a KAM because significant judgment is required but it doesn't use anything entity-specific to explain why a significant judgment is required? Like, what are the factors in that specific situation?
>
> -senior accountant and securities regulator

As explained by one audit partner, this is really where a KAM adds value, otherwise "we are better off with no KAM":

> It needs to be specific to the entity itself. It needs to be tailored. It can't be boilerplate… I think it is key to have the approach and in bits of how it was undertaken. Because that

is really the only additional value of KAM. Otherwise, it is, "well, we reviewed everything." Like, how is this different from any other section that we've done work on? So, if we just say a blanket and very high-level statement, I don't think we are better off with no KAMs in that situation.

-audit partner, mid-tier firm

In order to assess this dimension of communicative value, we use cosine similarity, a textual analysis technique that compares text passages. A cosine similarity measure can range from 0 to 1 — with similar passages being closer to 1 and dissimilar ones closer to 0. Appendix D – Sample Description Passages with Low, Average, and High Fog Scores provides examples of valuation of fixed-asset KAMs that have a range of similarity measures.

As Figure 3.2 illustrates, across the first year of implementation, there is a fair degree of variation (cosine similarity score averages a relatively low 0.43) among the KAMs within each topic or sector. This suggests that even when describing a similar KAM topic for entities within the same TSX industry sector, Canadian auditors have made an effort to develop customized, and arguably entity-specific KAMs.

Figure 3.2a: Average Cosine Similarity Score Across KAMs – Same Sector and Same KAM Type Pairs

	Comm & Media	Consumer	Financial Services	Industrial	Life Sciences	Mining	Oil & Gas	Real Estate	Tech nology	Grand Total
Allowance for loan losses			0.43							**0.43**
Business structure events		0.57	0.36							**0.46**
Impact of oil and gas							0.61			**0.61**
Inventory				0.29						**0.29**
Long-term liabilities			0.43			0.27				**0.38**
Revenue recognition				0.33					0.38	**0.35**
Valuation of fixed assets		0.55	0.35	0.48		0.43	0.55			**0.46**
Valuation of intangibles	0.41	0.44	0.35	0.48	0.31	0.44			0.36	**0.42**
Valuation of investments			0.32			0.26		0.50		**0.42**
Grand Total	**0.41**	**0.46**	**0.35**	**0.44**	**0.31**	**0.42**	**0.57**	**0.50**	**0.37**	**0.43**

Note: The intensity of the shading in each cell indicates the number of KAMs reported in that sector or KAM type, with darker shading indicating more KAMs reported.

However, per Figure 3.2b, in a much narrower year-over-year comparison of recurring KAMs, there is very little or even no change as evidenced by the much higher cosine similarity values averaging 0.89 across the data set. These recurring KAMs were reported for the *same* issuers on the *same* topic in both their first and second years of implementation. Note that the data set for Figure 3.2b includes only those entities for which the second year KAMs were included in the data set at the time of our analysis.[7]

Figure 3.2b: Average Cosine Similarity Score Across KAMs by Sector – Year-Over-Year Same Issuer/Same KAM Type

	Clean Technology	Comm & Media	Consumer	Financial Services	Industrial	Life Sciences	Mining	Oil & Gas	Real Estate	Technology	Utilities & Pipelines	Grand Total
Allowance for loan losses			1.00	0.96	1.00							**0.97**
Business structure events	0.94		0.73	0.69	0.94	0.78		0.68		0.95	1.00	**0.83**
Environment (matters arisin..			0.97				0.88		0.96	0.97		**0.95**
Impact of oil and gas							0.82	0.82				**0.82**
Inventory	1.00		0.96	0.96	0.92	0.91	0.79			0.99		**0.93**
Long-term liabilities			0.97	0.87	0.97	0.99	0.94		1.00		0.99	**0.92**
Other					0.99						1.00	**1.00**
Revenue recognition	0.99	0.94	0.89	0.97	0.98	0.93		0.87		0.87	0.99	**0.94**
Taxes		1.00	0.99	1.00	0.98		0.99	0.98			0.89	**0.98**
Valuation of fixed assets	0.97	0.96	0.97		0.68	1.00	0.88	0.81	0.95	0.98		**0.82**
Valuation of intangibles	0.92	0.98	0.97	0.96	0.97	0.97	0.90	0.99	0.93	0.78	1.00	**0.95**
Valuation of investments	0.95		0.71	0.83	0.99	1.00	0.94	0.49	0.96		0.98	**0.89**
Valuation of other assets			0.98		0.99	1.00						**0.99**
Overall	**0.95**	**0.97**	**0.90**	**0.87**	**0.89**	**0.96**	**0.86**	**0.82**	**0.96**	**0.88**	**0.98**	**0.89**

Figure 3.2c shows the same narrow data set of "recurring" KAMs that was used in Figure 3.2b, except viewed from the perspective of audit firms rather than sector. Again, the average cosine similarity across the data set was very high at 0.89, suggesting little change from year to year in these KAMs.

Figure 3.2c Average Cosine Similarity Score Across KAMs by Firm – Year-Over-Year Same Issuer/Same KAM Type

	Deloitte	E&Y	KPMG	PwC	Grand Total
Allowance for loan losses			0.96		**0.96**
Business structure events	0.75				**0.75**
Impact of oil and gas			0.88	0.78	**0.82**
Inventory			0.99	0.92	**0.96**
Long-term liabilities	0.97	0.78	0.99	0.96	**0.92**
Revenue recognition	0.99	0.92	0.95	0.97	**0.96**
Valuation of fixed assets		0.88	0.80	0.83	**0.83**
Valuation of intangibles	0.98	0.98	0.97	0.92	**0.96**
Valuation of investments	0.90	0.99	0.90	0.85	**0.89**
Overall	**0.92**	**0.92**	**0.91**	**0.86**	**0.89**

E&Y: Ernst & Young; PwC: PricewaterhouseCoopers

[7] Because the data set for the 2021–2022 period is not yet complete, this is a partial analysis covering only those entities for which 2021–2022 KAM data had been included in the Audit Analytics data set by mid April 2022.

This “atrophy to boilerplate”, a term used by one audit partner, may mean that over time, reports can become less useful. In some instances, as highlighted below, boilerplate is inevitable and, therefore, a logical outcome.

> …inevitably you know they are going to get a little boilerplate. And kind of your question earlier: Do you write them from scratch, right? You are not going to write them from scratch. So, you end up with this, “well, is there a reason to change it?” And if there is no reason to change it, then they stay the same. And so, they stay the same, so now they are boilerplate. But you got to boilerplate through logic, right?
>
> -audit partner, Big Four firm

PricewaterhouseCoopers UK (PwC UK) cautions that a potential complacency over risks can lead to reports that are “misleading in their portrayal of the current audit.” However, one professional practice partner explained that they expect this complacency, or familiarity bias, with regard to consideration of which risks qualify as a KAM. Therefore, in the consultation process, they challenge the conclusions made by the engagement partners. In the next section, we examine more closely the Canadian implementation experience.

4 A Closer Look at the Canadian Implementation Experience

Audit committee members, auditors, and preparers are the key stakeholders involved in the financial reporting process for the TSX-listed companies. Based on 27 interviews with members of these three groups, we provide a summary of their views on the effect of KAMs on the audit and financial reporting process, as well as the benefits and challenges of implementing KAMs.

4.1 The Impact of KAMs on Audit Firm Processes

Since KAMs represent an audit reporting requirement, the implementation of KAMs most affected auditors. In the first year, it involved a significant amount of time, and, as this partner noted, more than what was expected:

> You know, we thought it was going to take at least 10 to 15 hours additional at the very least of very senior people's time. And I think if I do the math, it took us much more time than that for any file last year and the year before.

-lead KAMs partner, mid-tier firm

Much of the time senior auditors spent on KAMs was in reviewing and consulting on the appropriate KAMs and on which KAMs should be reported. Plus, a lot of time was spent actually drafting the KAMs. While the introduction of KAMs involved considerable time for each individual audit file, there was also significant time and resources allocated to developing policies on the broader issues such as:

- What is a KAM?
- What will be the recurring KAM?
- What should you do when faced with no KAMs?
- What should you do when there is a going concern close call?

Despite this, most of the recurring practices developed were incremental and had only a limited effect on the audit process itself.

Building on the US experience

As discussed in Section 2, all firms had the benefit of being able to draw on the experience of their US counterparts. As explained by one professional practice partner:

> So when we started planning for it two years ago, we started with the US materials. We looked at what was the critical audit matter. And, you know, there are some differences between them. Critical audit matter — like, you know, our starting point was that. And then we modified it for CASs. And then we wrote up the guidance for here for Canada.

-lead KAMs partner, mid-tier firm

And, in the end, as explained earlier, Canadian KAMs look very much like US CAMs. The Canadian firms have largely adopted the US definition of a CAM — those matters reported to the audit committee that relate to an account or disclosure that is material to the financial statements and involved especially challenging, subjective, or complex auditor judgment.[8] This definition is narrower in focus than the International Auditing and Assurance Standards Board (IAASB) definition, and, as a result, Canadian KAMs do not include other matters, such as those related to internal controls, as allowed by Canadian Auditing Standards (CAS) 701, *Communicating Key Audit Matters in the Independent Audit Report.* The underlying rationale provided by professional practice and engagement partners is that they are precluded from reporting any "original information" as defined by CAS 701 (paragraphs A34 to A36).

Unlike auditors in other jurisdictions, such as the United Kingdom and South Africa, who sometimes disclose KAMs that are beyond the requirements of CAS 701,[9] Canadian auditors, as described by one audit partner, "are bound up pretty good." As this partner further explains, the nature of the Canadian institutional environment does not motivate auditors to go beyond complying with the standards.

> There is a bit of "why would I go beyond standards?" You are kind of putting your neck out there. And again, it is not so much — you know, as my mentor said to me many years ago — as part of the audit practice, we are in the risk business, right? So we take risks. But I would go back to "is it material?" Like, is it that meaningful that you are willing to take risk?
>
> -audit partner, Big Four firm

Identifying recurring KAMs

In the first year of implementation, Canadian firms focused on identifying recurring KAMs. Although some engagement auditors are more comfortable with zero KAMs, the professional practice staff are often more hesitant. This hesitancy becomes evident in situations where the initial plan was to report just one KAM, related to a one-time transaction (such as an acquisition), and would not be relevant in the next year. This creates the potential for zero KAMs in years that do not have any significant one-time events.

> I think in the standard or at least, you know, it is kind of saying that it would be rare that you would have no KAM, right? So, I think KAMs is kind of done on a relative basis; i.e.,

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[8] The PCAOB Release 2017–001 (PCAOB, 2017) expands on this and explains that it is not necessarily a single account or disclosure and it could be those that have a pervasive impact.

[9] The ACCA report, *Key Audit Matters: Unlocking the Secrets* (Gambier, 2018), provides several examples of KAMs reported in other jurisdictions, such as turnover of key accounting personnel and risk of reliance on component auditor.

> you know something in the company could end up to be a KAM that would not be a KAM at another company. [ ]
>
> But when you have companies that [ ] don't have a lot of acquisitions, they don't have impairment, they are doing well, you know, then you have to find, like, "where do you spend a lot of your time? Where are the judgements and so on?" And then you start looking at inventory provision. And, you know, sometimes there is some judgement in there, but there is not a lot of judgement. So, that kind of ends up being the KAM.
>
> professional practice partner, Big Four firm

In trying to ensure the entity is not an outlier, the downside to searching for a recurring KAM is that a KAM may be reported for the sake of reporting a KAM, which may be somewhat misleading. One audit committee chair, a recently retired Big Four auditor, shared her experience when an acquisition KAM reported in the first year no longer qualified as a KAM:

> The first year, their KAM was an acquisition, which makes total sense. You know, they were buying the company, and they spent a lot of time on it. And they needed to talk about the blah, blah, blah.
>
> And the second year, the acquisition wasn't a year old, and with the KAM, I felt like they were struggling to come up with one. And they—sorry, this is a distribution company, so inventory is not difficult. And they used the excuse that — I am going to use excuse in a kind of a negative way — it was material, because I didn't feel that it wasn't. It had gone up in value; it was the biggest item on the balance sheet. But there is no complexity to it like you would expect in impairments or intangible assets and things.
>
> So, I think the underlying sort of tone that was going on with the audit committee and management was, well, you just have to find one. You've got to have one. So, I am being totally honest with you because, you know, to me, okay if they don't have one, then they don't have one?
>
> -audit committee chair; retired Big Four auditor

Dealing with Zero-KAM situations

While some auditors, preparers, and audit committee members seem to be comfortable with reporting zero KAMs, others express concern and are somewhat surprised that TSX-listed entities would have zero KAMs.

> I'm surprised that companies can say, "well, we don't have any." I never saw critical accounting matters or key accounting matters being a red flag accounting issue. It was more to me a disclosure — an enhanced disclosure. Now, maybe I had it wrong, and these companies are taking the view that unless there is a red flag or a yellow or red flag going on, we are not going to say anything.

-audit committee chair; retired CFO

Auditors are sensitive to this issue. When there appears to be a possibility of zero KAMs being reported, there is extensive consultation and review at multiple levels. Not only are auditors concerned about the risks involved with reporting zero KAMs, but audit partners are also concerned about the implications for audit fees.

> We came to the conclusion last year — both ourselves and the US firm — that there are some facts and circumstances that led to have been no KAM conclusion […] There are multiple levels of scrutiny, challenge or view in the firm to make sure we get to the right answer on that. So, it's not just one person making a decision, saying, "I don't think I have a KAM…" Even from a professional practice perspective, we have a group of partners right up to the top risk partner of our firm from an audit perspective that gets involved in those conversations, because we view it the same way as the client does. Is it putting us at risk? Is it putting our client at risk by not having a KAM?
>
> The other interesting thing about that no-KAM conclusion is that we hear this a lot from our partners… "What is the impact on audit fees based on the number of KAMs that you have?" So, if you are sitting here telling me there is no KAM, then why am I paying you X dollars for the overall audit? So, it is a very interesting viewpoint on it. And what does that look like? Because I will say that even when there are or aren't KAMs, the amount of hours that we spend to get to those conclusions is a lot.

-professional practice senior manager, Big Four firm

Dealing with going concern close calls

Our analysis shows that only 1% (6 out of 543) of audit reports authored by auditors based in Canada were close call or COVID-related going concern KAMs. By contrast, 12% (9 out of 75) of KAMs reported by international auditors were close call or COVID-related going concern KAMs. We asked partners why auditors from different jurisdictions (United Kingdom and Australia) would be more likely to have a going concern KAM (referred to as a close call) than Canadian auditors. Most auditors described the treatment of going concern to be a binary decision. There is either:

1. **material uncertainty** — a material uncertainty paragraph is included in the audit report; or
2. **no material uncertainty** — no additional disclosure is required in the audit report.

Many auditors pointed out that often a going concern assessment involves limited judgment — for instance, the auditor finds evidence that the client has received additional funding. However, going concern assessments sometimes require significant auditor judgment and resources, which would seem to meet the definition of the KAM (if the client did not provide a going concern disclosure).

We asked each of the professional practice partners their views on close calls. One professional practice partner described their recent experience with a complex going concern assessment and described how they came to the decision that they were faced with a “true close call” and a KAM was necessary:[10]

> And I think that was a situation where it was not very clear the going concern should have been a significant risk or not at the time. Like, if there is going to be going concern known or not in the financial statements. And the team did a lot of work. And in the end, it was decided that going concern is not going to be known in the financial statements. But then I think we had added that as a KAM—
>
> But I think the reality is that the client had put together a 20-page memo here. And we had done so much work on it. And I think it was hard to get out of it to say that it is not. We had done a significant amount of work on it, where it went through a consultation. It went through so many levels of review. And it was a true close call. So, by standards we have to put it there.

-KAMs leader, mid-tier firm

Despite not having the going concern disclosure, as described by another professional practice partner, the disclosure requirements of International Accounting Standards (IAS) 1, *Presentation of Financial Statements*, regarding significant management judgments would capture close calls because management would have to detail the assumptions they used to determine that the basis of a going concern was appropriate. However, another firm’s professional practice focused on the binary decision of whether to prepare the financial statement on the basis of a going concern or not. They argued that since the KAM must be tied to a financial statement note and, since, unlike the Financial Accounting Standards Board’s (FASB) guidance, in Canada there is no requirement to disclose management’s plans, the auditor cannot include a KAM because that would mean the audit report includes original information.

One partner, who has been consulted on several going concern situations, believes the best way to manage the auditor’s risk is to require a going concern note, with an emphasis of matter paragraph:

> You get kind of slicing and dicing because if you didn’t have the emphasis of matter and it was a close call, in theory could you have, and I use again quote unquote “close call,” right? In theory, could you have a KAM? You could, but then think about if you step back the risk of that. Like, oh shit, here is what we focused on. And we didn't have an EOM, but we put it as a KAM, right. So, I think what you will typically see is probably just put

[10] This KAM was not in our database since it related to the subsequent year.

> the emphasis of matter in, not necessarily have a follow-up KAM, because your opinion is not modified anyways, right?
>
> -audit partner, Big Four firm

Despite guidance issued by the AASB (AASB & AcSB, 2021) and IFRS (IFRS Foundation, 2021), there is no clear consensus on when it is a close call to prepare financial statements on a going concern basis in Canada.

Working paper templates and matrices

All of the firms developed templates and matrices to document:

- the rationale behind why the matter was or was not determined to be a KAM; and
- consistency between the audit plan presented to the audit committee and what is described in the audit report.

As both of the following quotes highlight, the practices were developed with the aim to avoid any audit deficiencies in the event of a practice inspection.

> We did update our templates as well to sort of think about what kind of questions the regulator was going to ask us in terms of what is your scope of KAM? And what is your starting point? So, in thinking about what goes in our report to the audit committee, what do we communicate to the audit committee members? And really getting into that mind frame that we need to document why something is not a KAM.
>
> -lead KAMs partner, mid-tier firm

> The areas where incremental effort was [needed includes] consistency of communications, so [whatever] we communicated in the audit report, [matched what was] in the audit committee report. And then the KAMs over here. And we've got, for example, we've got the audit planning document that we would have, having some consistency between that in terms of what we said we are going to do and then the KAM. And so, at the end of the audit, we have this huge matrix to match all of these things up and make sure that what we said we are going to do is in fact done the way we said that we are going to do it in the file. And just making sure that everything is well documented.
>
> The first thing that a regulator will do is match the procedures that we say we did in the KAM to our file and see if in fact we did them. I would say that that is job one that the regulator would do.
>
> -audit partner, Big Four firm

Writing guidance

Each of the auditors noted that KAMs are hard to write and that auditors often struggle with this. To assist auditors, most firms have developed writing guides that provide tips and examples. One firm has an automated tool that flags “banned words” — including, for example, jargon or words deemed too complex — and overly long sentences. Whenever possible, firms strive for consistency in how they present KAMs.

> …an example like when we evaluated the discount rate for a goodwill analysis, when you are applying your discount rate. That is a pretty consistent procedure across all of our files in the practice. I wouldn’t expect that wording to be different KAM over KAM. So, we kind of have consistent, in areas where we can be consistent, we are consistent with things like that.
>
> -professional practice senior manager, Big Four firm

To further ensure that KAMs are clear and understandable, all the auditors stressed the importance of:

- having a cold read done by someone not involved with the engagement; and
- developing a database of KAMs that auditors can draw on for examples.

Others emphasized the efficacy of finalizing the wording of a draft KAM through a meeting with all reviewers present in order to reach a common understanding and consensus. This practice was developed in response to challenges with the original approach of trying to manage multiple rounds of drafts circulating to reviewers by email.

Importance of early consultation

Despite the level of agreement about what constitutes a KAM in general, the auditors stressed that to avoid wasting unnecessary time and costs, they consulted the risk management and professional practice staff to make sure the specific KAM or KAMs being considered for the client would ultimately be used. This was especially true in the first year, where the KAMs reported would set an implicit benchmark for future audit reports.

> Okay, before we go and spend our time writing something, let’s make sure that we are all on the same page about what it is… And there were a lot of situations in our shared drive … where we drafted KAMs, and we were like, we don't understand why this is a KAM. Why do we think this area is a KAM? Because people were just really eager to have them?
>
> -professional practice senior manager, Big Four firm

4.2 Impact of KAMs on Communications with Audit Committee

What should be listed as KAMs

In the first year, some audit committees had concerns over what information would be disclosed in KAMs. As one audit committee chair, who was familiar with the UK experience, explained:

> And, um, I thought about what that might look like with having Rolls-Royce in my head obviously. I was actually a little bit appalled because I was wondering how the auditors would balance the, um, sort of management's needs versus the audit requirements.
>
> And it turns out that all of the worries were unfounded. But I was also worried about, you know, all of a sudden, we are going to have a delay in issuing and filing financial statements because management and the auditors couldn't come to terms with what should be listed as KAMs. Or how many there should be. Or [laughing], how long the discussion was going to be. And what management secrets they were going to give away as a consequence of including the KAMs. So that was the stuff that I wanted them to work out.

-audit committee chair, retired CFO

Response from regulators

For some industries, as explained below, audit committee members were concerned about the potential response from various regulators.

> They were very concerned about what the regulators were going to think about it. They were concerned about, "is this going to put a target on our back or bring something to their attention that they might not otherwise look at?"

-professional practice audit senior manager, Big Four firm

Revealing tax-planning approach

Those organizations with tax KAMs were particularly sensitive around how the KAM could be interpreted in relation to their tax-planning approach or their views on particular tax jurisdictions. This audit committee chair explains:

> The tax one does increase concern among investors about your tax structure. It increases interest by taxing authorities if they see that you are doing quote unquote "high-risk tax." And so, it can lead to other impacts.

-audit committee chair, former Big Four auditor

Dry runs

To alleviate concerns and educate both the audit committee and management, many auditors performed a dry run. The dry run also helps the auditor:

> So, the year before where everybody had to adopt for the listed ones, we did a dry run to see, okay, for next year this is what the KAM would look like. And we went through the whole process as if we were going to have it, so that we left time in for the audit committee to look at the language. We worked with management to have them look at what we were proposing based on what we have in the note disclosure to the financial statements. And we also did the same dry run with our interprofessional practices while having them review the language. So, you know, preparing them in advance, I think, gave them a little bit more colour of, you know, this is what you should be expecting for next year.
>
> -partner, mid-tier firm

> Six to nine months before we actually did what we called this dry run is that we had almost an information session with each of our audit committees. And part of the Q2 for audit plan presentation we talked about: What is a KAM? Why are we doing this? What does this look like?
>
> …why the dry run was so important because we had to go back to our clients and say, “you need to improve your disclosures in order to make the KAMs reporting relevant and understandable.”
>
> -professional practice audit senior manager, Big Four firm

Creating KAMs content

When we asked the audit committee members about their involvement with the actual content of the KAMs, they were clear that they saw this as being beyond their role.

> And I don’t think it is our position as an audit committee to determine what the external auditors should report from a KAMs perspective. I don’t think that it’s not our responsibility. Our governance doesn’t extend to what the external auditors should say.
>
> -audit committee chair; former Big Four auditor

Communication between audit committee and auditor

One of the claimed benefits of the introduction of KAMs is the enhanced communication between the audit committee and the auditor. For instance, UK partners observe that the conversations between the audit committee and auditors are richer and more focused (ICAEW, 2017; Wilson, 2021). However, as explained by this audit partner, the introduction of KAMs has had a limited effect on the nature or frequency of audit committee communications:

> Early on I thought this might impact what we communicate to the audit committee on a quarterly basis. But, really, I don't give it a second thought. I really don't until we start looking at it from a KAMs perspective. So, I would say, you know, initially we thought maybe it would, but I don't think it has at all.
>
> -audit partner, Big Four firm

Apart from the increased communication related to the dry run and the details of the first-year implementation, there was an overwhelming consensus among the audit committee members that there was no substantive change in the communication between audit committees and auditors. In fact, many felt that there was no value added at all.

> From an audit committee perspective, we will then have discussion with the external auditor as to whether or not those are the right ones [KAMs], or whether there should be others. But, quite frankly, there is nothing in the KAMs that from the audit committee's perspective we hadn't already spent a lot of time talking about and discussing. So, from the audit committee's perspective, again, the bottom line I would have to say is there is not a whole lot of value to us because it follows on the work that the external auditors have done that has been reported on to us that we have had large discussions on already.
>
> -audit committee chair; retired Big Four partner

However, it is important to note the audit committee members we interviewed all described the organizations that they oversee as having mature governance structures. Therefore, it is possible that KAMs could have a positive impact on those entities with weaker governance structures and control environments.

4.3 Impact of KAMs on Financial Statements and Involvement of Preparers

Wording

As the quote below from an audit committee chair for several TSX-listed entities indicates, in many cases, the more detailed discussions of the KAM's wording are between the auditors and management. This is not surprising since auditors want consistency between the KAM description and the financial statement note.

> I mean, when this started, I thought there might be a lot more discussion between management and the auditor on the wording of the KAM. That management might be concerned with how the auditor was portraying that particular risk and how it was being dealt with by the auditor. And that is where I thought that the audit committee might in fact have to play more of a role with respect to, you know, how that risk is being portrayed. And then how the auditor has dealt with it. But I haven't had any of that experience to date. Management and the auditors seem to be landing quite easily, I

> would say, with the wording that is being used. And, you know, as I said from our perspective, we are just satisfied that the risk has been appropriately dealt with.

-audit committee chair; former Big Four auditor

Process

This audit partner also describes a smooth process with little “pushback” from the preparers.

> I didn’t experience any pushback from preparers on, you know, can you change certain language or things like that. I think we are quite clear to say, you know, it’s our audit report. And we are required to tailor it to what we feel is appropriate.
>
> But at the same time, we just want you to look at it to make sure that it is factually correct and consistent with everything else we have been talking about so that there is, you know, this information or a poor choice of words. But I don’t think we have ever had issues around, too, what is the actual KAM itself. It is really more around the wordsmithing of the issue.

-partner, mid-tier firm

Often more discussion is around what CFOs consider to be “sensitive” KAMs, such as taxes, which may put the company at risk.

> I think the challenge of operating in [Country X], and this is what is understood by our investors is tax rules are actually generally quite vague. And the regulations around taxes and payments and tax calculations are not as prescriptive as they are in Canada or even in the US. And so, just in everyday tax calculations are an element of judgment that needs to happen. And so, through that, there are all these risks that we with all good intent take a position that is not in line with the rules…The concern was really making sure that we weren’t leaving breadcrumbs for the tax authority to say, look, these are areas that we think are high risk.

-CFO, mining company

For others, the conversations are more robust.

> I don’t think we ever encountered *prickly*, but a lot of “why it is needed?” And, frankly, some level of “we don’t think this is necessary” in certain circumstances. And there was, you know, a couple times in a conversation back and forth, like any other suggestion that you make to clients that have strong qualified people in the chair. They’ve got a viewpoint, and they express it. And it comes to some accommodation generally that works for both parties.

-audit partner, Big Four firm

Modifying disclosures

Some do mention that their clients had to modify disclosures:

> They had a, for example, like for *impairment*, they had, there is an accounting policy they might've done some sensitivities. They might have had a note disclosure on how they dealt with it. But I think it needed a little bit of scrubbing just to make sure that, you know, management's approach is well described in here. Because I think in the past, because we didn't have KAMs, we were less particular about exactly how they described their issues. Like, if it lacked a little bit of clarity, it was something that we can live with.
>
> But because now we have KAMs, we need to work on that left side of the column. And we wouldn't want to be adding more information that is not in your financial statements there themselves. [Laughing]: So, the better approach becomes: tweak the language in here because you are saying it anyway; you are just not saying it clearly. So, if you tweak the language in here, it allows the left side, or the reference to management's work, to be exactly the same language.

-audit partner, mid-tier firm

However, others did not need to do so. As highlighted by this CFO, those who prioritize having clear financial statement disclosure would likely not see much impact on their notes:

> I would say, no, it didn't change much at all because we had [....], I think we had — very good disclosure around risks at the company. It was something that the audit committee and management always had as a priority.

-CFO, utility company

A chance for improvements

Some preparers who have had internal control issues in the past, noted that KAMs gave them the chance to push for improvements:

> You asked me about cost-benefit. The benefit to me has it allowed me to push my team and my folks to take their responsibilities more seriously. You know, I think yes would be my answer. I don't think the cost to me has been excessive.

-CFO, technology company

Cost-benefit

National practice people, who have a bird's-eye view of their firm's TSX filers, report that KAMs have led to improvements in financial statement disclosure. However, as highlighted below, some question whether the cost is worth the benefit.

> …Financial statements are iterative processes. They improve every time somebody looks at a note and spends a lot of detailed time on it. It improves. And it cuts out superfluous wording and kind of get more to the heart of it. And so, you got a lot of high-priced talent looking at these notes because they are trying to make sure they tie with the rest of it. And so, yes. But was it worth the cost? Probably not.

-audit committee chair, retired Big Four partner

Value

Like the auditors and audit committee members, many preparers wonder if anyone actually reads the KAMs and, given the auditors' focus on managing their own risk, if there really is any value in KAMs.

> I just think that auditors are always very focused on managing their risk. And not exposing themselves to potential claims. And so, I think, in my view, that overly motivates or influences auditors to draft their KAMs in certain ways. And so, I just kind of see it as much of anything as a CYA process for auditors rather than something that is necessarily helpful even if someone were to read it.

-CFO, mining company

4.4 KAMs Reporting in Subsequent Years

While there was significant effort in the first year of implementation, from developing policies and processes, to implementing a dry run, all the stakeholders involved in the financial reporting process say that the second year is much less onerous.

As part of their subsequent-year KAMs discussions, some auditors are providing data to preparers and audit committees concerning the type and number of KAMs reported for their peers, as well as the year-over-year change. This is particularly true for those industries where the competition is closely monitored. Some auditors have even provided comparative details, such as the number of words per KAM, for peer issuers. This information helped audit committees see the context of their own KAM disclosures in their market subsector. As several audit committee members and preparers mentioned, "no one wants to be an outlier."

4.5 Benefits of the KAMs Implementation

Although the primary purpose of implementing KAMs was to better inform users about the audit, non-user stakeholder groups noted several practical benefits that arose as part of the KAMs implementation:

Disclosure improvements

Auditors reported that some improvements to financial statement disclosure practices were achieved. Typically, these improvements were made to accounting policy notes to facilitate the auditor’s articulation of the KAM risks without disclosing original information. Preparers and audit committee members confirmed that minor modifications to notes were made in some instances; however, on a cost/benefit basis, it was of limited value to them.

Incentive for clients to address weaknesses

In some situations, auditors used the KAMs implementation to pressure clients to improve processes. These processes had previously been flagged as significant weaknesses but had gone unaddressed. One auditor mentioned working with a client to ensure information technology controls were strengthened before the KAMs were implemented; another mentioned pushing the client to carry out robust impairment testing instead of relying on the auditor to carry it out.

Additional auditor reflection

Some auditors commented that the process of drafting KAMs forced them to articulate their reasoning and audit procedures, and, in doing so, they were able to gain a sharper focus and reflection on the audit issues. Nevertheless, auditors consistently emphasized that the substance of the audit was not changed because KAMs were introduced.

4.6 Challenges Associated with the KAMs Implementation

Auditors reported a number of challenges associated with the implementation of KAMs:

Time-consuming

Most auditors reported having underestimated the amount of time required to draft KAMs, particularly for the first few audits. Time requirements lessened in subsequent years as auditors got used to KAMs and what was previously novel became routine.

New processes

Firms modified processes and working papers to capture KAMs reporting decisions and to ensure appropriate review before publication. Auditors developed efficiencies through trial and error as they implemented new processes.

Few contextual examples in the early stages of implementation

Auditors of early filers mentioned the uncertainties they faced as issuers of the first KAMs reported in the Canadian environment. Despite an informal consensus within the profession regarding KAMs (for example, consensus around the level of detail to be reported or the types of KAMs likely to be reported), there was some trepidation with the early audit reports. These concerns dissipated as the body of published KAMs grew in line with consensus expectations.

Identifying KAMs for some clients

The implementation of KAMs brought implicit pressure on auditors to identify at least one KAM for each client. However, for some clients, auditors had difficulty identifying a reportable KAM. In these situations, auditors sometimes described "scraping the bottom of the barrel" in considering matters that could be reported as a KAM.

Zero-KAM reports

Closely related to the challenge of identifying KAMs for some clients was the prospect of issuing a zero-KAM report. As noted earlier, very few enhanced audit reports in the Canadian market (less than 3%) were issued with zero KAMs. This dovetails with the behind-the-scenes discussions taking place at the firms. Auditors described some apprehension that issuing a zero-KAM report could draw negative scrutiny or legal exposure. Because of these concerns, zero-KAM reports often took just as much time to review as reports with multiple KAMs. Some auditors requested clearer guidance from AASB on zero-KAM reports; others were comfortable with the guidance provided and suggested that norms would develop over time.

Recurring versus one-off KAMs

Another issue related to the challenge of identifying KAMs is the distinction between recurring and one-off KAMs. *One-off KAMs* are usually associated with a transaction such as an acquisition or divestiture that is reportable in only one period; *recurring KAMs* are associated with issues that are expecting to require ongoing judgment calls such as valuations. Some auditors noted that they had inadvertently set up for a future zero-KAM report by issuing a single one-off KAM in the first year. Given the concerns around issuing zero-KAM reports, auditors reported being more deliberate about considering subsequent years' reporting when issuing each client's first enhanced audit report.

Variability in writing skills

Professional practice staff reported seeing a range of writing skills reflected in the early drafts of KAMs submitted for review. This is consistent with engagement auditors reporting on the challenges they faced in distilling their significant risk reporting down to a concise paragraph written in plain language.

Sensitive KAMs

Preparers and audit committee members noted some concerns around KAMs issued on sensitive topics, and the importance of appropriate risk framing in these circumstances. For example, in the mining industry, KAMs related to uncertain tax positions in foreign jurisdictions were carefully scrutinized. Wording was occasionally adjusted to avoid inadvertently offending tax authorities (for example, through implicit suggestions that the rules or courts were politicized) or inadvertently suggesting to users that the company was taking an inappropriately aggressive tax position.

Client concerns

Auditors, audit committee members, and preparers reported a large variation in the intensity of clients' engagement with the KAMs reporting process. Based on the descriptions provided by interviewees, most clients (preparers and audit committee members) appeared to follow the process with interest but remained mostly hands off. Only a small number of clients were more heavily engaged, primarily in the first year as they were trying to understand the KAM selection process. Although more time was spent with the more engaged clients, none of the auditors reported having significant client challenges over KAMs reporting.

5 The Users' Experience

Since KAMs are intended to enhance communication between auditors and users and to increase users' confidence in audit reports (IAASB, 2015), our analysis would not be complete without reaching out to users and obtaining their views. We interviewed ten "sophisticated users" — analysts, both on the buy and sell sides, who represented a variety of institutions and one senior account from a securities regulator. Of that group, five had audit experience and five had a finance background (see Appendix B – Participant Profiles for more details on their backgrounds).

5.1 User Awareness of KAMs

When we asked auditors, audit committee members, and preparers if KAMs have helped narrow the expectations gap, they invariably asked if investors actually even read KAMs. Given that investors likely don't read them, most users question their usefulness.[11]

> So, my view would be it [the usefulness of KAMs] is limited. You know, is there a world where it could be helpful for certain companies? Maybe. […] I do question how many investors actually read that section of the audit report. And so, you know, that clearly raises one area of limitation that if investors don't read it, then they are not going to find it useful.

-CFO, mining company

Several mentioned that they never receive questions about KAMs on conference calls and none of the CFOs had ever had an analyst reach out to make an inquiry regarding their KAMs. Those analysts who provide research to institutional investors report a similar experience:

> I mean, if you think about what my job is and how I have never once been asked about it. Let's put it that way — not once in the last two years, no institutional investor has asked me about the auditor's report.

-sell side analyst, finance background

When we asked the sophisticated users if they had read any KAMs, the only user that had actually read numerous KAMs was a securities regulator accounting expert. Other than that individual, one of the analysts noted he had come across a KAM by accident when performing a keyword search of the annual report of a real estate company he followed.

[11] Gambier (2018) had a similar finding — that sophisticated users were unlikely to read the audit report. This is based on a series of roundtable discussions the ACCA conducted in Cyprus, Greece, Abu Dhabi, Oman, and Romania, during which auditors, audit committee members, and academics discussed the new audit report.

> There was one REIT [Real Estate Investment Trust], I think, that talked about the key risk being the valuation of investment properties. And so, I — and they had some disclosure about I can't remember what it was anymore. It was about the valuation methodology. But they — the auditors — were talking about, like, how they checked the methodology. How many properties they sampled. But there was some kind of quantitative metric in there.
>
> I did look at it because it was interesting finding out how they value these properties. Because it was — because they talked about the impairment loss related to investment properties. And they talked about how they calculated that. So that stood out to me.

-buy side analyst, audit background

None of the other users had read the KAMs. In fact, most admitted that they were unaware of any changes to the audit report, KAMs included. Most admit they do not read the report.

> I stopped reading auditors' reports after I stopped participating in writing them. It's unfortunate, but that's the truth.

-buy side analyst, audit background

Similarly, this senior analyst, who manages a large group of analysts, canvassed his staff to see if they were aware of the changes to the audit report.[12]

> We went from three paragraphs to four pages. And the reality is, okay, unless you are really into this, do you really notice anything? I get answers out of eight analysts, they are senior analysts. People who have more than 10 years', 15 years' experience. And nobody noticed anything. Nobody looks at it.

-buy side analyst, audit background

Some are more hopeful:

> In general, it is fair to say that user awareness of KAMs is probably still developing.

-senior accountant, securities regulator

However, since most users do not see the need to read the audit report, an awareness campaign may help to educate users. While it is not so surprising that those analysts with a finance background have not heard of the changes in the audit report, as highlighted below, even the CPAs (who have worked as auditors) are unaware of the changes.

[12] Prior to our interview with him, he canvassed his staff to see if anyone was aware of the extended audit report.

> There was like no communication about them to me. So then, I just didn't. I think I heard about them, but I just it wasn't, like, marketed to me, I guess. I just didn't really know about them. I just noticed it was longer to scroll to the balance sheet.

-buy side analyst, audit background

Rather than simply report that users do not use KAMs, we considered why this is so and what would make KAMs useful or "interesting" — the term used by many of the interviewees. "Interesting," from their perspective, is something that they could use in their models and/or risk assessment or something that would pique their interest and their desire to find out more.

5.2 Information Overload

Not surprisingly, all the analysts are overwhelmed with information,

> especially for public markets, we live in a time where data hits the tape — the news tape — in matters of seconds after it's out.

-buy side senior analyst

Sophisticated users need to triage and identify what is important in order to stay ahead of the pack.

> I am saying that the problem that I have as a sophisticated investor is that I need to be ahead of the other investors. Not of the audit report. I need to be ahead of my competitors. And they are damn quick.

-buy side analyst, audit background

Automated tools play a role in sifting through information, and only in rare instances is the audit report considered "interesting."

> Some of these news flows we get are automated. So, Bloomberg, which is the source that we use quite extensively for financial data, has automated news or results analysis [....] So, an auditor's report is part of this news flow that we would get if there were anything in the auditor's report — it would be flagged right away in a matter of seconds. So, that's why when everything is clean, no one reads it.

-buy side analyst, audit background

> [The audit report] is one of those things that it doesn't matter until it matters.
>
> And so, if there is fraud, then you point your finger at the auditors. Like, why didn't you do your job? If there is a material internal control weakness or a restatement — a massive restatement, right? — or if the audit report is qualified for a large public

> company, then I think there's questions. But when it is routine as it is the vast majority of times, then I don't think a lot of my coworkers would care.
>
> -buy side analyst, audit background

Even in those situations, the audit report is often a lagging indicator, and other information is already available:

> Other hints that we see before an actual auditor's report, you will see a regulator, say that "we are inquiring on a transaction". Or "we are looking at statements that were made". Those type of inquiries tend to have fairly material impacts on stocks, especially if investors already had a little doubt that maybe something was aggressive.
>
> -buy side analyst, audit background

5.3 No Need to Understand What Auditors Do

Since users do not read the audit report, one could argue that KAMs have not helped to achieve the IAASB's goal of increasing users' confidence. However, as this analyst explains, perhaps this is not so important in the Canadian context. Sophisticated users have confidence in the assurance provided in the audit report. And users do not really value the added transparency of the audit process, which the KAMs provide.

> Our team of equity analysts would be comprised of about 20 people…. I would say that there is a high chance that they don't [understand what an auditor does] because they spend the majority of their time understanding — trying to understand — business models. And the role of the audit to them is almost automatic.
>
> It's like when they get on a plane, they assume that the aircraft maintenance has been done and you don't ever think about it. And I think, with audit, it falls in that bucket where whatever work they do in the company, they assume that, you know, living in a developed country, there is good professional association and standards that are all taking care of that for them.
>
> -buy side analyst, audit background

5.4 Users Responses to KAMs

Rather than relying on the views of those who are involved in the financial reporting process, as to what constitutes a *good* KAM, we asked users themselves. Since most had not read any KAMs, to assist them with this question, we provided KAMs from well-known Canadian companies, and asked for their reactions. We made this adaption to our research questions after an early user interviewee demonstrated the value of viewing KAMs while the interview was underway. This individual accessed the annual reports of several large Canadian companies, which he was aware had significant events, and read the KAMs to see if they were "interesting."

Although, per CAS 701, an explanation about the outcome of the procedures is optional, we did not find any evidence that auditors based in Canada include outcomes or observations in their KAM reporting. However, some of the international auditors that report on Canadian-listed companies (primarily UK auditors) do report KAM outcomes.[13] In addition to the KAMs from well-known Canadian companies (issued by auditors based in Canada), we also provided users with several examples of KAMs that included outcomes as shown in Appendix F – Sample KAMs with Outcomes Provided to User Interviewees. The KAMs we selected had outcomes with varying degrees of specificity. We then asked the users if they found the outcomes to be useful or interesting.

We've summarized the responses to the KAMs provided.

Number of KAMs

In general, the analysts prefer not to be overloaded with the number of KAMs and most seem to think that two or three KAMs is a reasonable number.

> I would focus on, yeah, yeah, less than a handful — two or three. Otherwise, you are just going to dilute the message. And it's going to be too hard on the reader.
>
> -sell side analyst, finance background

> Well, the more they have, the less likely I am to read them [....] But I guess less is more is where I would lean towards [....[But, if there is three really material things, then gosh, please write about them, yeah.
>
> -buy side analyst, audit background

Close call KAMs

While there is much discussion at the standards-setting level regarding close call KAMs, there was a tepid reaction among users regarding auditors providing a close call KAM. Again, analysts see this as old news and of no real value.

> What we really try to spend a lot of time on is forecasting the equity value of the business. And so, hopefully, we would be ahead of issues like that. And I guess that is literally what we get paid to do. And so, the real value of this [a close call KAM], I guess, would be for non-professional investors who don't have the time to spend on that. Which is arguably more important to protect them and the investing public.
>
> -buy side analyst, audit background

[13] We pulled these examples from our database.

Canadian-style KAMs

Users also had a tepid response to the Canadian-style KAMs. When asked for feedback on the procedures, most felt that the information did not provide any additional insight and, therefore, was not interesting. Below are a few excerpts from a discussion about an acquisition KAM.

> Like, in terms of what procedures they did. And, you know, it doesn't tell me anything kind of additional, I guess, about the business because of course they would have legal documents — like, you know, I get it is descriptive, but it is very dry. It doesn't tell me anything else about the acquisition.

-buy side analyst, audit background

Further, KAMs are not interesting because they are old news, and do not provide any insight into the future.

> I mean, they would have already dealt with a lot of this on the conference calls.
>
> I think the company did a reasonable job in terms of articulating these in its disclosure outside of the notes themselves. And I would think for the auditor trying to understand, you know, what the long-term implications were of some of these decisions would almost be impossible in this case.

-buy side analyst, finance background

Like this analyst, despite KAMs providing a level of assurance, the information is of limited value to analysts in their decision-making process.

> As I read it, I say, of course you are going to have this [referring to procedures]. [*Laughing*]. The auditors here in this case. But it does nonetheless provide me with a level of assurance. I just felt more comfortable in the integrity of the statements after having read that.

-buy side analyst, audit background

When we asked this analyst if they thought they'd "check out those KAMs" going forward, they confirmed they would not.

UK-style KAMs (with outcomes)

The response to the UK KAMs, which included the outcome of the procedures, was somewhat more positive. For instance, in comparison to the Canadian KAMs, this analyst finds that the outcome "closes the loop."

> I really like these. I really like these a lot. They are concise, number one. And the language is just straightforward. It's easy to understand if you are an accountant or not. And they are common sense. So, they explain what the issue was. I like how they close the loop — that our internal specialist thought it was different, but the difference was not material. These are great. I really like that they reach a conclusion that ultimately the […] investor would worry about it.
>
> -buy side analyst, audit background

When the interviewer asked if this analyst would seek these KAMs out, they said they would:

> Yeah, I would make use of this. I think this is something we would want the analyst to be aware of if we could sort of capture this here. From an investor perspective, this is very valuable. I wish we [Canada] had this.
>
> -buy side analyst, audit background

However, the UK KAMs that merely stated that management's approach was reasonable were considered of limited value.

Some users mentioned that having the conclusion or outcome at the beginning of the procedures section (as the audit option) and perhaps highlighting it would be useful as well.

> And, ideally, I would want that, to benefit the investing public, that the conclusion should be bolded or be in a box or something, like, to orient, like, read this. This is the synopsis, right? Like a book summary — I don't want a book.
>
> -buy side analyst, audit background

> I think that key observation — if that was put up to the very top, that's useful. [*Laughing*]. Honestly, like the bottom line first, right?
>
> -buy side analyst, finance background

Although users would consider a granular conclusion to be insightful, given Canada's institutional environment, most auditors and former auditors do not see this as being possible. As explained by this audit committee chair, who is a recently retired audit partner, "it is too high of mountain to climb":

> I think it is just going to be too hard to get the firms to agree to that. There is too high of a mountain to climb that you know they want to step back. Maybe if the legal, you know, ramifications of that weren't so high. And the insurance that they pay [*Laughing*] to companies that, you know, because let's talk about fraud. It has come a long way from when we [auditors] would just put our hands up and say, we don't do fraud. And now there is an expectation that, yeah, if we missed a fraud, then that is the auditor's fault.

So, if we concluded on the KAM and it was wrong, that is going to be the auditor's fault. And I think it is a slippery slope that the auditor doesn't want to go down.

-audit committee chair; former Big Four auditor

I think it's one thing to say that we are taking conservative views. It is another thing to put it in writing. And put yourself in a position where someone could say that you said that you took the conservative position and then some information comes out that could possibly suggest that it was anything but conservative. So, my inclination would be to probably not be comfortable with that type of disclosure going out.

-audit committee chair; former CFO

5.5 What Information Would Make a KAM Interesting?

The table below highlights the type of insights that users would like auditors to provide. We note that many of these items are shared with the audit committee. However, like the inclusion of outcomes in KAMs, it would be a "high mountain to climb." Some of the items, like acquisition accounting, may be addressed with additional financial statement disclosure.

Information	Explanation
Additional details about balance sheet accounts for cash flow models	An expansion of detail around long dated receivables and impairments and potential impairments would be useful because that is the true cash cost, right? I have seen industries that I've covered where companies will trade up price-to-book, sometimes for years on end. And yet the auditors don't impair. And I would love to know why they don't impair them. -sell side analyst, finance background
Insight into acquisition accounting	I guess the one area that I am finding often that is quite obscure is acquisition accounting. And how goodwill was actually allocated. Having a little more insight into that would be interesting as well. Often times, you know, you never understand fully of how something was accounted for. You will see a

Information	Explanation
	lump of goodwill or intangibles or both and you are still not sure how they came up with that. -buy side analyst, finance background
Insight into quality of management's judgments	Any insight into management's behaviour about how they go through the audit process and how the numbers are created would be helpful. I mean, to see something in print saying, like, management is aggressive in their assumptions, like, that would be something that would be read by someone. Because, unfortunately, it would probably be viewed as somewhat inflammatory, which then makes it useful. -sell side analyst, finance background
Points of contention between auditor and management	I would be curious more of what were the points of contention between the two parties. You know, what really were, what were the three things that they deliberated on the most? Like, as I said, particularly when it gets to write-downs, you know, I will often ask the company, "why didn't you write off more?" Because, like I said, why waste a good recession? And oftentimes, it comes down to: the auditors just said that that was not appropriate. Or we were being too aggressive in terms of what we were trying to write off. And some companies will give you that additional insight into what that discussion was like. -buy side analyst, finance background
Insight into changes: Why changes in a recurring KAM? Why was a KAM dropped?	So, yes, they are repetitive, and yes, they can be generic. But, compare this year's risk disclosure to last year's. That change didn't happen by accident. And if it happens, then sometimes a slight change in the

Information	Explanation
	wording can make a significant difference to the implication of the sentence. -buy side analyst, audit background

6 Impact on the Next Wave

Most TSX Venture filers will be subject to enhanced auditor reporting for yearends after December 14, 2022. Stakeholders that participated in the implementation for TSX filers had mixed views on whether and how the implementation of the TSX Venture would differ.

Some proposed that it would be a non-event and will be viewed as a simple compliance exercise.

> For the Venture issuers, it is going to be a non-event. It will just be one more thing they have to do. The Venture issuer auditors and the, you know, many of the Venture issuers — whether they are in the high-tech business, the biotech, the mining, the oil and gas — the critical business decisions are going to be: does this product work, does this drug work, is there gold, is there oil on these properties? Like, the auditor is not going to contribute to any of those risks. So, no, it is going to be much less valuable for the Venture issuers because they are smaller; they've got simpler businesses.
>
> I think we've demonstrated that in North America, the legal system will force a fairly anodyne description of critical audit matters. And it becomes even less useful the further down the food chain you put it.
>
> -audit committee member; former Big Four partner

However, these "simple" businesses have less-developed governance and reporting systems, which may make the implementation of KAMs more difficult both from the auditors' perspective and the preparers' or audit committee members' perspectives:

> The maturity of your disclosures and, you know, financial statement notes and things like that — in our case, because it's mature, it is seamless really. But for TSX Venture companies, who might obviously not have that same level of maturity, or, I guess, my advice for those companies for their CFO and audit committees is, you know, they really ought to be for those areas that have that level of materiality and subjectivity and complexity and judgment. They really ought to be looking at their note disclosures and making sure and doing maybe some benchmarking. And, really, making sure that they've got robust disclosure there.
>
> -audit committee member; former Big Four partner

As a result, a dry run can be very useful to help identify the KAMs.

> I think for those companies, it is going to be critically important that they do the dry run because there are, it is possible and maybe reasonably likely, but I really shouldn't make that judgment that the KAMs for those companies are going to be way more difficult. I think to, um, maybe not to land on as to what they are because, again, it is probably driven by audit risk.

> But then what you say about them — they have all kinds of accounting issues because they don't have staff, they don't have full-time people. It is just a whole different environment. So, I think doing the dry runs — and I think the audit firms are going to have to be very proactive and having early conversations with those companies about what KAMs are and why they have to be reported.
>
> -audit committee member; former CFO

While there may be difficulties, the introduction of KAMs may help improve some of the governance structures.

> I think it will be difficult for them, but I do believe that it will actually create discipline. The question is, "Are they able to ensure that they have the proper ICFR [internal controls over financial reporting] in place?"
>
> -CFO, technology company

Some suggested that there will not be the same level of anxiety and apprehension as with the TSX filers. There is now much more information out there about the type of KAMs likely to be issued, the depth of detail being reported, and the likely reaction from the user community.

There is also the increased possibility that KAMs may actually be used. Unlike the TSX-listed companies, where users draw on multiple sources of information, there is much less publicly available data for TSX Venture companies.

6.1 Hints and Tips for the Next Wave

For those auditors who have not had experience with the implementation of KAMs, we provide the following hints and tips to help the process go smoothly.

<table>
<tr><td colspan="2">Start early</td></tr>
<tr><td></td><td>Prepare stakeholders for implementation: Most auditors provided education to audit committees and clients before KAMs were implemented, answering questions like:
What is a KAM?
Why are KAMs required?
This was followed up with more specific questions as the implementation date approached:
What do KAMs look like in other clients' audit reports?
Who authors KAMs?
How are KAMs selected?</td></tr>
</table>

	• *Use a dry run to further prepare stakeholders:* Many auditors provided a mock-up of the new audit report in the year before implementation. This allowed preparers and audit committee members to consider KAMs customized to their organizations, and to assess their comfort with risk descriptions and wording without the pressure of imminent publication.
	• *Identify disclosure deficiencies:* An early start with draft KAMs can bring existing disclosure deficiencies in the financial statements to the surface. Wording that was acceptable in the pre-KAM context may no longer be sufficient to allow the auditor to articulate the audit risk. Changes can then be made without undue time pressure.
	• *Identify developing risk areas that could be mitigated:* The implementation of KAMs may provide an opportunity for auditors to dialogue with clients about improving risk areas (for example, weak controls) to avoid the need for a KAM.
	• *Clarify from the outset that KAMs are part of the* ***auditor's*** *reporting:* Although stakeholders respect the auditor's task, some auditors found it helpful to define the role of the preparers and audit committee members. Circulate draft KAMs not to open negotiations but to have stakeholders point out factual errors or misleading implications.
Expect significant time demands	
	• *Budget generously:* Most auditors were surprised by the time consumed in drafting and refining KAMs. Some participants quoted upwards of 15+ hours per KAM for drafting and reviewing.
	• *Expect high levels of senior staff time:* Almost all the time invested in KAMs is senior staff time.
	• *Provide sufficient lead time for Professional practice review:* KAM reporting typically occurs in a condensed timeframe; issuance of the audit report could be delayed if professional practice staff don't have sufficient lead time for review.
"Sell" KAMs to clients	
	• *Senior staff attention to audit file:* Clients can take advantage of this unique opportunity for a more intensive review of their financial statements by additional, senior staff members at the firm.

	• *Improved disclosure:* In some cases, intensive review of KAM and related notes leads to suggestions for improvements to financial statement disclosures.
	• *Non-controversial in the user community:* No evidence thus far that KAMs are causing controversy in or unwanted questions from the analyst community.
Establish an effective KAM consultation process	
	• *Engage professional practice:* Most auditors found professional practice reviews helpful. Professional practice staff have experience with KAMs across many clients and topic areas and can provide useful suggestions.
	• *Use a live call to finalize drafting:* Circulating multiple drafts by email can be inefficient and Inconclusive because of various competing versions.
Consider ongoing KAM reporting	
	• *Establishing a KAMs practice baseline:* The first KAM reporting cycle establishes implicit expectations, with stakeholders regarding the KAMs selection and drafting process, as well as the number and type of KAMs reported. Auditors noted the importance of being deliberate in setting those expectations.
	• *Recurring versus one-off KAMs:* Auditors distinguished between the two types of KAMs. Most indicated a preference to report at least one recurring KAM in the first reporting cycle to avoid the prospect of "defaulting" into a zero-KAM report in a year when there were no transactions or events that would lead to a one-off KAM.
	• *Zero-KAM audit reports:* Less than 5% of Canadian enhanced audit reports issued before December 14, 2021, have zero KAMs.
Draft effective KAMs – Every word matters	
	• *Use plain language:* Plain language helps all readers, including those outside of the audit or accounting profession, understand the report.
	• *Use entity-specific wording:* Research shows that the use of precise facts and circumstances in describing risks helps increase decision usefulness. It helps readers connect more vividly with the information, making it more

	memorable. Where applicable, refer to amounts, asset descriptions, and economic circumstances the entity faces to customize the KAM to the entity.
	• *Refer to previously published KAMs or KAM databases:* Simple, clear language that may have already been developed for similar KAMs can be used as a starting point.
	• *Mirror language used in the financial statements:* Minimize reader confusion by using the client's terminology (for example, *sales* versus *revenue*, *fixed assets* versus *long-lived assets, loss* versus *impairment*).
	• *No original information:* KAM descriptions should not provide information that the client has not already disclosed. Review the financial statements — and related notes — and KAMs simultaneously to verify.
	• *Ensure procedures are accurately described:* o Singular versus plural – Is the correct form used? (Tested *controls* or *control*? Validated through authoritative external *sources* or *source*?) o Scope of testing – Does wording imply 100% coverage when a sampling basis was used? o Precision – Does wording capture the procedure accurately? ("What I mean is…" is not sufficient)
	• *Occurrence:* Was every test listed actually carried out and documented in the audit file?
	• *Materiality:* It's not necessary to include every procedure undertaken, but must ensure all critical procedures have been described.
Use KAMs as a branding opportunity	
	• *Consistent presentation:* Most firms use a standardized presentation format for KAM reporting as part of branding efforts.
Address fee concerns	
	• *Some client pushback on fees associated with KAMs:* Auditors experienced some fee resistance from clients on fees. Techniques such as framing enhanced reporting as a professional requirement and "selling" KAMs as noted above helped clients accept the fees.
	• *Multiple factors affecting fee negotiations:* Some auditors reported that KAMs were one of many factors driving fee discussions with clients. In these cases,

	recovering the costs of reporting KAMs was achieved through larger fee negotiations.
	• *Base fees in subsequent years:* Most auditors reported that KAMs were subsumed into base fees after the first reporting cycle, particularly for recurring KAMs. The cost of producing one-off KAMs were typically included in additional fees assessed for the one-off matters.
Anticipate easier subsequent year experiences	
	• *Reduced time commitment:* Auditors reported devoting less time to KAM reporting after the first year. Auditors, preparers, and audit committee members were all much more comfortable once the initial reporting was established.
	• *Few changes for recurring KAMs:* Most auditors planned few changes to recurring KAMs in subsequent years unless circumstances or the audit approach changed, or the wording could be incrementally improved.

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APPENDIX A – POPULATION DETAILS

1. Data Set Characteristics

Data used: Audit Analytics Canadian KAMs database, for the first full year of mandatory KAM reporting (that is, entities with yearends after December 15, 2020, and before December 14, 2021). In practice, the yearends ranged from December 25, 2020, through November 30, 2021.

Inclusions: All entities that reported KAMs were included, not just those that were mandated to report during that period, which are those entities traded on the TSX that do not report CAMs under US audit standards.

Limitations: Audit reports with zero KAMs are not recorded in the data set. However, by searching a related data set that includes all audit reports issued in the Canadian market, we were able to identify and add to the analysis audit reports containing the phrase "no key audit matters." We expect this phrase would be present in most, if not all, audit reports that contain zero KAMs.

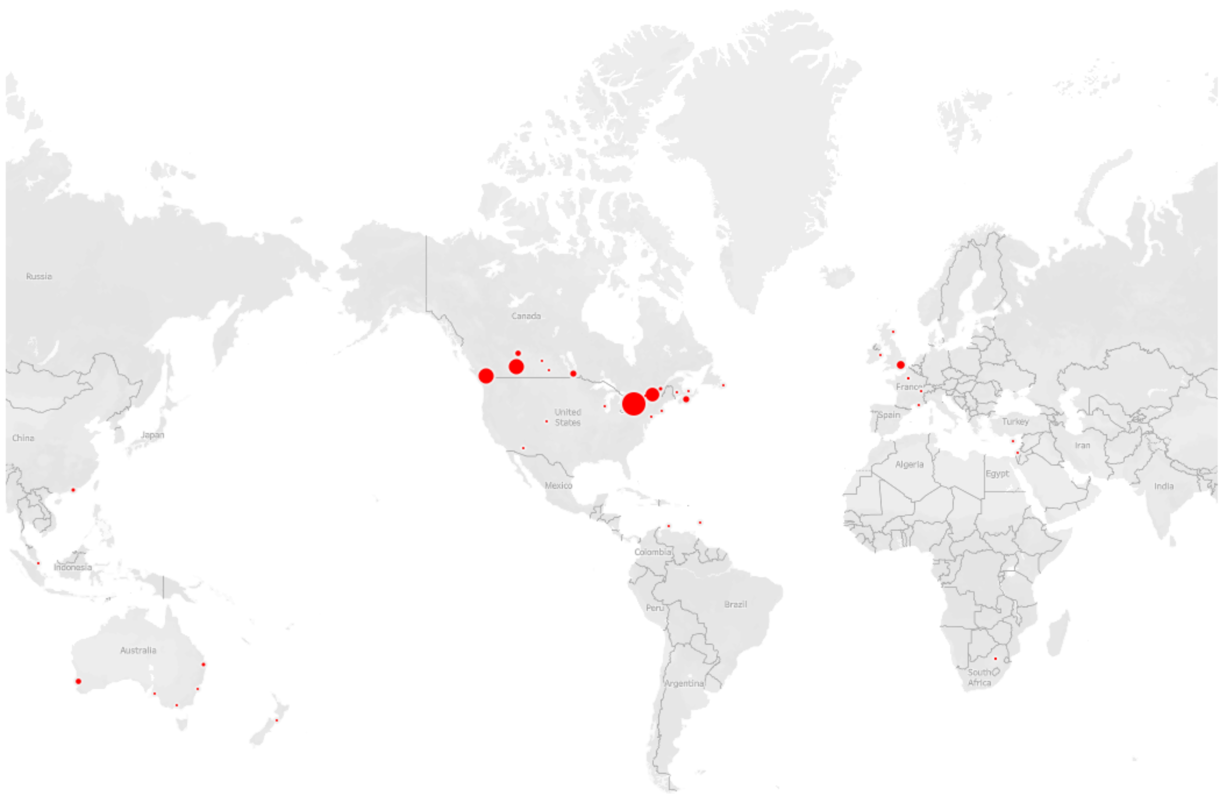
Modifications: Going concern paragraphs are counted as KAMs in most cases under the Audit Analytics KAM collection protocol. These were excluded from the analysis because they don't follow the typical KAM format and are not consistently recorded by Audit Analytics.

Standards used: Audit Analytics does not record the audit standards referenced by the auditor, even though this information is included as part of the audit report. The assumptions used for this study were that:

-All audits signed by an auditor based in a Canadian city (as disclosed on the audit report) were assumed to have been prepared using Canadian GAAS.

-For audits signed by an auditor based in a city outside Canada, the audit report was reviewed to determine which standards were used.

2. Auditor Locations



Note: the magnitude of the circles/dots is proportional to the number of audits within the sample issued by auditors in the identified locations

2.1 Distribution of fiscal yearends across the period

December yearends account for the large majority of reporting entities at 493 out of 618, or 80%. For auditors based in Canada, the concentration of December yearends is similar at 436 out of 543, or 80%.

2.2 Distribution of Clients by Audit Firm

Across the full set of 618 audit reports, Big Four firms dominate, serving 467 out of 618, or 76% of the client base. The clients served by auditors based in Canada is even more concentrated with 460 out of 543, or 85%, of the client base audited by Big Four auditors (PwC, KPMG, Ernst & Young, and Deloitte).

APPENDIX B – PARTICIPANT PROFILES

Participant Category	Characteristics	Total

AUDITORS		
Big Four firm	• All Big Four firms represented • Four professional practice staff from three firms • Across Canada (for example, Vancouver, Calgary, Toronto, and Halifax) • Many sectors (banking, extractive, grocery, telecom, real estate, manufacturing, and media)	7
Mid-tier firm	• Three mid-tier firms represented • One professional practice partner • Vancouver and Toronto • Many sectors (mining, real estate, technology, cannabis, manufacturing, agriculture, and food)	3
Total		**10**
AUDIT COMMITTEE MEMBERS		
Retired Partners	• Mostly retired Big Four auditors • All audit committee chairs on at least one board	7
Retired CFOs	• Some CFOs had audit experience (non-recent) • All audit committee chairs on at least one board	4
Total		**11**
PREPARERS		
Former auditors	• Industries represented: consumer packaging, telecom, financial services, mining, and technology	5
Industry background	• Industries represented: clean technology and mining	2

Total		**7**
SOPHISTICATED USERS		
Audit background	• All have CPA designation, and all analysts have CPA - CFA [Chartered Financial Analyst] designation • One regulator • Three buy side analysts (two formerly sell side analysts) • One sell side analyst	5
Finance background	• All have CFA designation • One sell side analyst • One credit analyst • Three buy side analysts	5
Total		**10**
GRAND TOTAL		**38**

APPENDIX C – Fog Scores Related to Various Financial Reports

	Average Fog score	Source
College graduate	17	Wikipedia
US analyst reports, 2002–2009	18.7	DeFranco et al., 2015
US annual reports, 1993–2003	19.4	Li, 2008
US Management Discussion & Analysis (MD&A), 1993–2003	18.2	Li, 2008
US Notes to financial statements, 1993–2003	19.0	Li, 2008
London Stock Exchange (LSE) non-financial audit reports, 2013–2017	21.1	Abdelfattah et al., 2021
LSE, Irish Stock Exchange (ISE) non-financial audit report KAMs, 2012–2014	27.35	Smith, 2019

APPENDIX D – Sample Description Passages with Low, Average, and High Fog Scores

Low Fog Score (more readable than the average KAM description)

Score = 16.24

KAM Topic: Valuation of intangibles

KAM Title: Evaluation of the goodwill impairment analysis of the United States South's group of cash generating units (469)

We draw attention to Notes 3 and 9 to the financial statements. The goodwill balance is $136.0 million and relates to the United States South's group of cash-generating units. The Entity performs goodwill-impairment testing on an annual basis and whenever events or circumstances indicate that the carrying amount may not be recoverable. The recoverable amount is calculated based on the higher of its fair value less direct costs to sell and its value in use. Significant assumptions used in determining the value in use include future sales volume, commodity prices, production costs and discount rates. Why the matter is a Key Audit Matter: We identified the evaluation of the goodwill impairment analysis for the United States South's group of cash generating units to be a key audit matter. The value in use was sensitive to changes in certain significant assumptions. Significant auditor judgment was required in evaluating the results of our audit procedures. Further, specialized skills and knowledge were needed to evaluate the discount rate assumptions.

Average Fog Score

Score = 22.69

KAM Topic: Valuation of intangibles

KAM Title: Capitalization of labor costs to property, plant and equipment and to intangible assets in the Telecommunications segment

As described in note 15 to the consolidated financial statements, the carrying value of goodwill allocated to the Film Production & Audiovisual Services CGU amounts to $9.1 million at December 31, 2020. Management assesses at least annually, or at any time if an indicator of impairment exists, whether there has been an impairment loss in the carrying value of Goodwill. Determining whether the carrying value of goodwill is recoverable requires management to estimate the recoverable amount of the related CGU on the basis of the higher of its fair value less costs of disposal and its value-in-use. When estimating the recoverable amount, the forecasted cash flows of the Film Production & Audiovisual Services CGU can be volatile being driven, to a large extent, by the timing of significant movie productions. The recoverable amount of this CGU is based on its value-in-use and is sensitive to assumptions such as revenue growth rates, earnings growth rates, terminal growth rate and associated pre-tax discount rate. Given the relative sensitivity of these assumptions to the impairment testing process, and the complexity in auditing them, the valuation of the goodwill of this CGU is considered a key audit matter.

High Fog Score

Score = 27.82

KAM Topic: Valuation of fixed assets

KAM Title: Mineral Properties – Assessment of Indicators of Impairment or Impairment Reversal – Refer to Notes 2 and 6 to the financial statements

The Company's determination of whether or not an indicator of impairment or impairment reversal exists at the Red Chris, Mount Polley and Huckleberry cash generating units requires significant management judgement. While there are several inputs that are required to determine whether or not an indicator of impairment or impairment reversal exists, the judgements with the highest degree of subjectivity are future copper and gold prices, discount rate and ability and timing to restart mine operations at Mount Polley and Huckleberry mines. Auditing these estimates and inputs required a high degree of subjectivity in applying audit procedures and in evaluating the results of those procedures which resulted in an increased extent of audit effort, including the involvement of fair value specialists.

APPENDIX E – Examples of KAM Pairs with Different Levels of Cosine Similarity

<table>
<tr><td colspan="2">NOTE: This base KAM (KAM 1044) is compared to the three others. Highlighting in the “Very Similar KAM” below indicates similar words and passages.

KAM 1044: Evaluation of indicators for impairment or reversal of impairment of non-financial assets</td></tr>
<tr><td>Judgment is required in assessing internal and external indicators of impairment or impairment reversal. Internal and external indicators for capital and other non-financial assets include significant changes in the extent or manner in which an asset is expected to be used. Indicators for exploration and evaluation assets include the period for which the Entity has the right to explore, expected renewals of exploration rights, whether substantive exploration and evaluation expenditures on mineral properties are budgeted, and results of exploration and evaluation activities on the exploration and evaluation assets.

Management also considers whether sufficient data exists to indicate that the carrying amount of capital assets and exploration and evaluation and other assets is unlikely to be recovered in full from successful development or by sale.

Why the matter is a key audit matter: We identified the evaluation of indicators for impairment or reversal of impairment for non-financial assets as a key audit matter. This matter represented an area of significant risk of material misstatement given the magnitude of non-financial assets and amounts previously</td><td>How the matter was addressed in the audit: The following are the primary procedures we performed to address this key audit matter: We inspected exploration license renewals and discussed with management if any rights were not expected to be renewed to assess the status of the Entity’s rights to explore.

We compared the Entity’s actual exploration and evaluation expenditures in 2020 to the budgeted expenditures to assess management’s ability to accurately budget.

We read the Entity’s exploration budget for the upcoming year to determine whether the Entity has plans to incur further exploration and evaluation expenditures.

We read information included in the Entity’s technical reports and internal and external communications to assess if the Entity has decided to continue or discontinue exploration for and evaluation of mineral resources in the specific area.</td></tr>
</table>

<table>
<tr><td>reported as impaired. This matter was of most significance due to the judgment required to evaluate the results of our audit procedures and assess the Entity’s determination of whether the judgments, individually and in the aggregate, result in indicators of impairment or reversal of impairment.</td><td></td></tr>
<tr><td colspan="2">Very similar KAM

Cosine similarity measure = 0.9005

KAM 937: Evaluation of indicators of impairment for exploration and evaluation assets</td></tr>
<tr><td>Description of the matter: We draw attention to Notes 2(c)(ii), 3(d), and 5 of the financial statements. The Entity has exploration and evaluation assets of $29,364,155. Exploration and evaluation assets are assessed for impairment if facts and circumstances indicate that the carrying amount may exceed its recoverable amount. Judgment is required in determining whether indicators of impairment exist, including factors such as the period for which the Entity has the right to explore, expected renewals of exploration rights, whether substantive expenditures on further exploration and evaluation of resource properties are budgeted and results of exploration and evaluation activities on the exploration and evaluation assets.

Why the matter is a key audit matter: We identified the evaluation of indicators of impairment for exploration and evaluation assets as a key audit matter. This matter represented an area of significant risk of material misstatement given the magnitude of exploration and evaluation assets. This matter was of most significance due to the judgment required in evaluating the results of our audit procedures to assess the Entity’s determination of whether the factors,</td><td>How the matter was addressed in the audit: The primary procedures we performed to address this key audit matter included the following:

We assessed the status of the Entity’s rights to explore by inspecting license renewals, discussing with management if any rights were not expected to be renewed and inspecting government submissions made during the year.

We compared the actual exploration and evaluation expenditures in 2020 to the budgeted expenditures to assess management’s ability to accurately budget.

We read the Entity’s exploration and evaluation budget for the upcoming year to determine whether the Entity has plans to incur further exploration and evaluation expenditures.

We read information included in the Entity’s technical reports and internal communications to assess if the Entity has decided to continue or discontinue</td></tr>
</table>

individually or in the aggregate, resulted in an indicator of impairment.	exploration for and evaluation of mineral resources in the specific area.
Average similarity KAM **Cosine Similarity = 0.3597** **KAM 1085: Assessment of impairment indicators for property, plant and equipment (PP&E)**	
Refer to note 2d – Basis of presentation – Critical accounting estimates and judgments, note 3g – Significant accounting policies – Impairment of long-lived assets and note 4 – Property, plant and equipment to the consolidated financial statements. The Company's total PP&E as at December 31, 2020 amounted to $112.5 million. At the end of each reporting period, the Company's PP&E are reviewed to determine whether there are any indications that those assets may be impaired. Management makes significant judgments in assessing whether changes to certain factors would be considered an indicator of impairment, which include both internal and external factors such as: (i) a significant decline in the market value of the Company's share price; (ii) changes in quantity of the recoverable reserves; (iii) changes in metal prices; (iv) changes in forecasted capital and operating costs; and (v) changes to the timing of achieving commercial production. No impairment indicators were noted.	Our approach to addressing the matter included the following procedures, among others: – Evaluated the reasonableness of management's assessment of impairment indicators, which included the following: –Assessed the completeness of external or internal factors that could be considered as indicators of impairment of the Company's PP&E. –Tested changes in quantity of the recoverable reserves, in metal prices, and in forecasted capital and operating costs by considering (i) the consistency of metal prices with external market data and (ii) the consistency of forecasted capital and operating costs with previously forecasted data, and whether these factors were consistent with evidence obtained in other areas of the audit. – Assessed whether there has been a significant decline in the market capitalization. – Assessed whether timing of achieving commercial production suggests that the carrying amount of PP&E exceeds the

<table>
<tr><td>We considered this a key audit matter due to

(i) the significance of the PP&E balance and

(ii) the significant audit effort and subjectivity in applying audit procedures to assess the internal and external factors evaluated by management in its assessment of impairment indicators, which required significant judgment.</td><td>recoverable amount, based on evidence obtained in other areas of the audit.</td></tr>
<tr><td colspan="2">Dissimilar KAM

Cosine Similarity = 0.1167

KAM 662: Impairment assessment for Mt Cattlin</td></tr>
<tr><td>The Group performed an assessment for impairment indicators across its cash generating units (CGUs) given this is required by Australian Accounting Standards. During the half year, the Group identified impairment indicators for the Mt Cattlin Cash Generating Unit (CGU), primarily due to a prolonged and further deterioration of current and forecast pricing in the spodumene concentrate market. As a result the Group performed an impairment assessment at the half year ended 30 June 2020 which resulted in an impairment charge of US$14.2 million. As part of the impairment assessment, the Group made significant judgments about assumptions, such as:

– Spodumene concentrate pricing

– reserve and resource estimates and production and processing volumes

– operating costs, capital costs for future developments, foreign exchange rates and inflation rates</td><td>We evaluated the Group’s assessment of whether there were any indicators of asset impairment at 30 June 2020 and 31 December 2020 for its CGUs, including considering whether there were any further impairment indicators for these CGUs which had not been considered by the Group. We performed the following procedures on the Group’s impairment assessment for the Mt Cattlin CGU:

– assessed whether the Mt Cattlin CGU appropriately included all directly attributable assets and liabilities

– considered whether the discounted cash flow model used to estimate the ‘fair value less costs of disposal’ (the impairment model) was consistent with the basis required by Australian Accounting Standards,

– assessed whether forecast cash flows used in the impairment model were consistent with the most recent budgets approved by the directors,</td></tr>
</table>

– discount rates At year end, in accordance with Australian Accounting Standards, the Group assessed for further indicators of impairment/impairment reversal for the Mt Cattlin CGU. This assessment indicated that significant judgments and assumptions made at 30 June 2020 remained appropriate in the circumstances and therefore the carrying value of the Mt Cattlin CGU at 31 December 2020 did not require adjustment. This was a key audit matter due to the significance of the Mt Cattlin CGU to the statement of financial position and the judgments and assumptions made in determining whether there were any impairment indicators, and the resulting estimates of the recoverable amount.	– assessed whether forecast cash flows used in the impairment model were appropriate and based on supportable assumptions by: • comparing spodumene concentrate pricing data used in the impairment model to external industry forecasts, • comparing the forecasted cash flows to actual cash flows for previous years to assess the accuracy of the Group's forecasting, • comparing foreign exchange rate and inflation rate assumptions in the impairment model to current economic forecasts, and • assessing the Group's discount rate calculations, including having regard to the inputs utilised in the Group's weighted average cost of capital such as peer company betas, risk free rate and gearing ratios, assisted by PwC valuation experts, – performed a sensitivity analysis on the key assumptions utilised in the impairment model, – performed tests of the mathematical accuracy of the impairment model's calculations on a sample basis, and – evaluated the adequacy of the disclosures made in note 12 including those regarding key assumptions used in the impairment assessment, in light of the requirements of Australian Accounting Standards.

APPENDIX F – Sample KAMs with Outcomes Provided to User Interviewees

1. Panel A: Full KAM with Outcome ("key observation")

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ADRIATIC METALS PLC

Key audit matter	How the scope of our audit addressed the key audit matter
1. Carrying value and Impairment of exploration and evaluation assets, and license compliance The Group's exploration and evaluation assets ('E&E assets') per Note 9 of the financial statements represent the most significant asset on the consolidated statement of financial position. As at 31 December 2020 £36,479,724 (30 June 2020: £9,045,169) of costs had been capitalised in relation to exploration activity. Management and the Board are required to assess whether there are any potential impairment triggers which would indicate that the carrying value of the asset at 31 December 2020 may not be recoverable. There are estimates and judgements applied in the identification of potential impairment triggers and within any models prepared to support the carrying value of the assets. Additionally, adhering to the specified terms of the Group's exploration licences in Bosnia and Serbia and keeping them in good standing is paramount to the continuance of further exploration work. Should specified terms not be adhered to, in the worst instance, the rights to further develop the assets could be withdrawn, which consequently, would impact carrying values. Given the materiality of the E&E assets in the context of the Group's statement of financial position and the significant judgement involved in making the assessment of whether any indicators of impairment exist we consider this to be a key audit matter.	Our specific audit testing in regard to this included: Reviewing management's and the Board's assessment of potential indicators of impairment of the E&E assets against the requirements if IFRS 6 in order to assess if any exist. Verifying the licence status, to confirm legal title and terms of use. Reviewing exploration activity to assess whether there was any evidence from exploration results to date which would indicate a potential impairment. Obtaining an understanding of management's expectation of commercial viability, inspecting any supporting technical documentation and discussing results and operations with management. Specifically, we reviewed both the competent persons reports compiled on the Rupice and Veovaca projects. Holding discussions with the Group's independent expert to understand and challenge the key estimates and judgements that support the scoping study and underpin management's assessment of commercial viability, as well as assessing their competence, objectivity and independence. Inspecting approved budget forecasts and minutes of board meetings to confirm whether or not the Group intended to continue to explore the project areas. Reviewing and assessing the adequacy of the disclosures in the financial statements to check that they have been prepared in accordance with the requirements of the accounting standards. **Key observation:** **Based on the procedures performed, we found the judgement and estimates made by management in their impairment assessment to be reasonable.**

2. Panel B: Sample KAM Outcome Statements

<u>KAM 1294</u>

Key Observations: We noted no material issues arising from our work in relation to the carrying value of mining assets. We found the judgments and estimates applied by management in preparing the forecasts to be supportable, although the net present value remains sensitive to changes in key inputs including silver prices, foreign exchange rates, resources and production levels, operating and development costs and discount rates. We found management's conclusion that no impairment charge was required as at 31 December 2020 to be supported by the underlying model. We found the disclosures in note 2, 9 and 10 to be appropriate.

KAM 1422

On the basis of our audit procedures, we are satisfied with the appropriateness of management's conclusion that there are no indicators of impairment of the group's oil and gas properties as at 31 December 2020. Although oil and gas prices fell during 2020, Serica's future price assumptions have not changed significantly and the recoverable amount of the group's oil and gas properties is not sensitive to any such changes as at 31 December 2020.

KAM 1468

We are satisfied that the key assumptions used to determine the recoverable amount of oil and gas assets and Magnus contingent consideration are materially appropriate, including estimates of reserves and production profiles;

• the Group's future commodity price estimates are within the acceptable range of external sources;

• we considered the sensitivity disclosure relating to the impact on the Group's goodwill impairment review of reasonable lower future commodity prices estimates with the conclusion that a change in assumption does not lead to impairment;

• the Group's discount rate is lower than the range calculated by our internal valuation specialists, but this resulted in an immaterial difference in the impairment charge which would have increased the impairment recorded;

• from the work performed, we are satisfied that the impairment recorded and the carrying value of the investments in subsidiaries are appropriate; and

• based on the procedures performed we are satisfied that the Group's impairment charge is appropriately estimated in accordance with the requirements of IAS 36 'Impairment of Assets'