Directors' guide 2020

Corporate reporting: Ask the right questions

In this issue:

Deloitte.

Institute for Audit Innovation and Quality

Directors' guide

Corporate reporting: Ask the right questions

The most effective boards create value by asking the right questions.

Companies and their management put processes, controls, and systems in place to accurately tell their financial story. Boards and their directors oversee the company and approve published financial and non-financial information. The external auditor evaluates the company's annual financial statements in accordance with professional standards.

The roles and expectations of the board and their directors in this financial reporting eco-system continuously evolve in a constant effort to instill public confidence in the preparation and accuracy of corporate reporting. From block chain and cybersecurity, to the digital transformation and the modernization of financial reporting, boards must stay ahead and be responsive to constant change.

This annual guide aids boards and directors of public companies to perform effective inquiries in their oversight functions. Directors of other organizations may also find this guide to be helpful.

We welcome your comments or questions regarding the content in this guide.

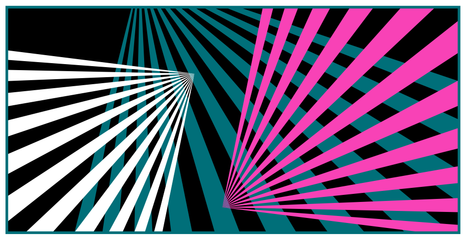
Richard Olfert
Managing Partner,
Regulatory, Quality, Risk & Reputation

Contents

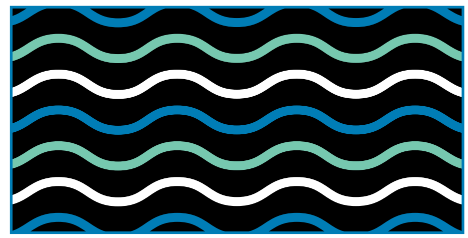
We are proud to provide you with our fully digital 2020 issue of our annual corporate reporting guide, which has been developed with directors in mind. Each section is designed to make it easy for you to connect to our specialist, access additional resources, and ask the right questions to fulfil your oversight responsibilities on a variety of topics.

Culture

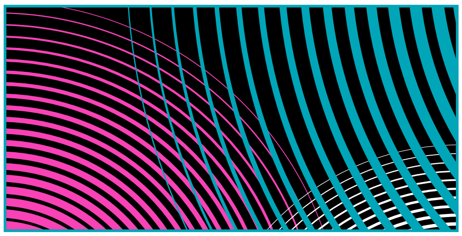
Transformation



Transparency



Corporate reporting



Checklists

Note: References to the "board" or "directors" could equally be a reference to the audit committee and its members, who are responsible for the oversight of the financial reporting process.

Secure your regulatory filings!

What will Canadian securities regulators look for in *your* company's annual report?

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Views from Deloitte's Securities Centre of Excellence

Change and uncertainty, whether in politics, the economy, or climate, are becoming the new normal. This presents business challenges and opportunities. Society and investors are focusing more and more on the longer term and on broader value creation. They are demanding purpose-led enterprises that incorporate a stated set of goals that put purpose beyond profit and, in turn, define a company's values and culture.

In that context, keep in mind that shortly after reporting issuers file their year-end financial statements and related filings, Canadian Securities Regulators ("securities regulators") will be conducting reviews of many of these documents. It is important that you be aware of the areas most likely to be the focus of these reviews. Annually, securities regulators will always conduct some focused reviews on the adoption of new accounting standards, so be prepared to respond to queries regarding the adoption of IFRS 16 Leases in the event your company is subject to a regulatory review.

Non-GAAP financial measures

Reporting issuers often use non-GAAP financial measures to bridge the communication gap between disclosures in the financial statements and key messages management wants to share with external stakeholders. As businesses and accounting standards have become more complex, the use of non-GAAP measures has increased significantly, with more focus being placed on these measures by securities regulators, investment research firms, standard setters, industry organizations, and investment managers.

Securities regulators in Canada are in the midst of converting CSA Staff Notice 52-306 Non GAAP Financial Measures (SN 52-306)[1] into securities law, specifically National Instrument 52 112 Non-GAAP and Other Financial Measures Disclosures (NI 52-112). Their intention is to improve compliance and enforcement as well as to address recurring disclosure issues. NI 52 112 was published on February 13, 2020 for a second 90 day comment. Despite the fact that new legislation is not currently in effect for calendar year-end companies, preparers of financial information should know that non-GAAP measures will remain an area of focus for Canadian securities regulators.

Here are five key themes to consider as you prepare your year-end reporting:

- Clarity – Are you disclosing multiple similar measures? If so, ensure it is clear why each measure is important and the different information each measure communicates.
- Accuracy – Does the name of your non-GAAP financial measure accurately describe the measure? Be careful when using words such as "non-recurring" or "operating" to ensure that these are accurate descriptors. Avoid using terms that could confuse the non-GAAP measure with similar GAAP measures.
- Usefulness – Is it clear why the measure is useful? Consider whether you need additional disclosure describing how the measure is useful to investors and how management uses the measure. Securities regulators will focus on disclosure that they feel is unbalanced or promotional. They will also focus on how non-GAAP measures are used to bridge changes in accounting standards, such as the adoption of IFRS 16 Leases.

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1 CSA Staff Notice 52-306 is a notice that provides the views of Canadian Securities Administrators' staff on how to avoid misleading disclosure when using non-GAAP financial measures.

- Consistency – Is the composition of your non-GAAP measure changing? If so, ensure you restate the comparative measure and describe the rationale for the change.
- Prominence – How are you communicating your GAAP measures in comparison to your non-GAAP measures? Securities regulators regularly comment when they view non-GAAP measures as more prominent than related GAAP measures. Prominence can be the number of times non-GAAP measures are disclosed, how many non-GAAP measures are used, which measures appear in headings or are presented earlier in a document, and the volume of analysis included.

While it is important to pay careful attention to non-GAAP measures in the annual MD&A, it is also necessary to consider how these measures are used in other documents, including investor presentations, social media, and websites.

Environmental, social, and governance (ESG)

There has been an ever-increasing focus by investors, analysts, governments, management, and employees of reporting issuers, those charged with governance, auditors, consultants, advocates of various organizations, and other stakeholders on climate change and climate change-related risks. All entities need to understand the risks specific to them and consider their communication strategy pursuant to these risks.

Canadian securities regulators under the umbrella of the Canadian Securities Administrators (CSA) published a second staff notice, CSA Staff Notice 51-358 Reporting of Climate Change-related Risks on August 1, 2019 on this important topic. This staff notice builds on CSA Staff Notice 51-333 Environmental Reporting Guidance dated October 27, 2010. The CSA chose not to implement new securities laws in this area, instead providing additional staff guidance on how to meet current broad reporting requirements that are embedded in a number of other securities laws.

The release of the second staff notice this year indicates that Canadian securities regulators will continue to focus on climate change-related disclosures. As a result of past reviews, regulators have noted concerns with boilerplate disclosure, with the result that there is a lack of meaningful information available to stakeholders. Regulators have commented on the lack of comparability and timeliness of disclosure as well as the fact that climate change-related risk disclosures made outside of the financial statements are often not connected to the reporting issuer's financial reporting. It is vital that management and boards of public entities understand key risks, including risks related to climate change, and have a communication strategy in place.

Canadian regulators will be closely monitoring global activity in the area of mandatory reporting of climate change related risks and entity responses to these risks. We believe that, over time, more specificity may be incorporated into Canadian securities law, either through amendments to current law, such as National Instrument 51-102 Continuous Disclosure Obligations, or stand-alone requirements in this area, such as the adoption of an existing global framework.

As you prepare your year-end financial reporting package, consider whether you have adequate disclosures to meet the increasing focus on risks related to climate change. Keep in mind that other jurisdictions may have additional disclosure requirements that are also evolving. This will be key to monitoring those reporting issuers with ties outside of Canada.

In addition to climate change risk, investors are increasingly looking for disclosure on human capital management and water scarcity. Transparency is an essential condition for investors to be able to make informed investment and voting decisions.

Digital transformation

There once was a time when an organization could wait and see which new technologies it should adopt, but today the need for transformation is critical and urgent. In this "Fourth Industrial Revolution," emerging technologies are boosting enterprises' efficiencies at levels not seen before and reshaping operating models. Beyond selecting the new technologies that are right for an organization—crucially, with the help of the right advisor or specialist—those that have successfully transformed themselves have also built a culture that is adaptable to change. And their boards have paired these modernization efforts with the modernization of the organization's corporate reporting.

Cybersecurity

Criminals who know no borders take advantage of enterprises' security gaps in an effort to compromise systems. They steal personal and financial information, intellectual property, and trade secrets, and they disrupt the infrastructure we rely on. Clients expect enterprises they've entrusted with their data to be prepared to respond effectively and quickly to breaches—something that this year was mandated in Canada. And there is more focus than ever on the ethical responsibility of enterprises when it comes to technology, including, but not limited to, protecting customers' privacy. It is crucial that organizations take the necessary steps to protect their own data and that of their clients.

New standards

The need to be transparent and timely has never been more important. Regulators are helping facilitate this on a number of fronts. One is disclosure overload: the CSA, the FASB, and the SEC are proposing to reduce redundant, immaterial disclosure requirements in order to improve clarity. The SEC is also looking for input on whether the quarterly reporting system fosters an overly short-term focus by management and markets. These are only a couple of examples of new auditing and accounting standards that are in the works. See the following sections for others: Key audit matters (page 42); Transparency and timely information (page 32); Significant accounting policies (page 36); and MD&A (page 58).

IBOR transition

By 2021, interest rate benchmarks such as interbank offered rates (IBORs), which play a key role in global financial markets, will transition to alternative risk-free rates (RFRs) in multiple jurisdictions. RFRs will provide more reliable rates and, unlike IBORs, they have little potential for manipulation. Phasing out IBORs should be a top priority for any enterprise involved in variable interest rate financial instruments, as the change affects every business. At the very least, boards should do an inventory of loans and credit facilities that will be impacted by the change and should review alternative financing means. Additionally, they should take action to avoid reputational, legal, and commercial risk. IBOR transitions will be unlike any other transformation program that enterprises have undertaken.

Statement of executive compensation

Developments around compensation include a possible "Say on Pay" requirement in Canada, where shareholders would vote on a public company's executive compensation. With investors' heightened scrutiny, it's important that enterprises demonstrate that their executive compensation is aligned with investors' interests. Another hot topic is pay ratios (the CEO's salary compared with the enterprise's median employee salaries; the ratio is 500 to 1 in the United States). Disclosure isn't yet mandatory in Canada, but the Business Roundtable—the leaders of around 180 enterprises, including Deloitte—recently committed to leading their enterprises for the benefit not only of shareholders, but all stakeholders, including employees and the community. The stakeholder approach to executive compensation is gaining momentum.

Companies in the cannabis industry

Legalization of recreational cannabis in Canada and the resulting entry of this industry into the Canadian capital markets has led to special attention being paid to cannabis companies by securities regulators. In addition to the risks, such as establishing and maintaining rigorous internal controls, inherent in being an emerging industry, recreational cannabis companies have some considerations specific to the nature of their product, including implications of relationships with the United States and other countries where recreational cannabis is not legal at a federal level. One area where securities regulators have noted a particular need for improvement is compliance with corporate governance requirements. On November 12, 2019, the CSA published guidance in the form of CSA Multilateral Staff Notice 51-359 Corporate Governance Related Disclosure Expectations for Reporting Issuers in the Cannabis Industry (SN). This staff notice was issued by staff of the securities regulatory authorities in Ontario, British Columbia, Quebec, New Brunswick, Saskatchewan, Manitoba, and Nova Scotia.

The staff notice (SN) focuses on two main issues, each of which is discussed below: (1) disclosure within securities regulatory filings of financial interests in merger and acquisition transactions; and (2) independence of board members.

- Financial interests in mergers and acquisitions: The cannabis industry has significant cross-ownership of financial interests between public companies and their directors and executive officers. This conflict of interest is material information in merger and acquisition transactions and requires disclosure in applicable securities regulatory filings.
- Independence of board members: Some cannabis companies have not appropriately considered potential conflicts of interest and have inappropriately indicated that certain board members are independent despite the existence of a material relationship. In some cases, the same individual holds the position of chair of the board of directors as well as chief executive officer. In this case, an independent board member must be appointed as lead director in order to provide assurance that the board can operate independently from management.

A written code of business conduct should be in place to assist companies in addressing the issues raised in the SN as well as other challenging situations.

We expect that this industry will continue to draw the attention of securities regulators. The management of cannabis companies can reduce the risk of a comment letter from regulators by doing a detailed review of their governance and related disclosures. In particular, consider the implications of cross-ownership of financial interests, conduct a thorough assessment of the independence of board members, ensure the chair of the board is independent or an independent lead director is appointed, and ensure the company has a comprehensive code of conduct.

Planning considerations

All organizations should put in place a rigorous process for assuring their directors of the quality and integrity of the organization's financial reports, including their relevance, reliability, comparability, and timeliness.

In addition, organizations need to appoint skilled staff, implement appropriate processes and controls, and undertake careful planning to achieve high-quality financial reporting.

"Has management reviewed the relevant aspects of the organization's continuous disclosure documents to ensure that these areas of focus have been addressed appropriately?

Some questions the board may wish to ask:

- Have we received a timetable for the completion of the year-end reporting? Does the timetable provide us and management adequate time to properly review and address issues that might arise?
- Does the finance or accounting function need additional specialized skills, experience, or resources to prepare the annual report and supporting information for the board? If additional resources are required, has a plan to develop those resources been implemented?
- Should we engage specialist advisors to help us meet our responsibilities? If so, have specialists been engaged?
- Are there plans in place to make a sound assessment of the appropriateness of the going concern assumptions to prepare the financial statements? Where material uncertainties exist, do the disclosures included in the financial statements and in the MD&A provide sufficient information about the uncertainties relating to operations, funding, cash flows, and how these uncertainties are mitigated? Where there are strong indicators of financial difficulty, do the disclosures include significant judgments made in concluding that there were no material uncertainties?
- Have we considered whether the internal audit function should undertake any additional work in anticipation of the year end? If so, is this work scheduled to be completed in time for us to consider the outputs prior to approving the year-end financial statements?
- Has a recent review been performed of the disclosure controls and procedures, and internal control over financial reporting to ensure that high-quality and timely data is available? Did that review conclude that additional resources, controls, or procedures were necessary and, if so, have these been provided or implemented?
- Have we defined "materiality" for financial information disclosures in the context of the users of the continuous disclosure documents and has that definition been communicated to management to assist in determining the financial statement presentation and disclosure?
- Has management reviewed the releases from the relevant securities commissions to identify areas of focus? Has management reviewed the relevant aspects of the organization's continuous disclosure documents to ensure that these areas of focus have been addressed appropriately?

Culture

- Corporate culture and conduct risk
- Environmental, social, and governance (ESG)
- Diversity on boards and in executive officer positions

Corporate culture and conduct risk

Looking for more guidance?

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More on this topic:

CFO Insights: 23 and You – How many traits of digital DNA does your company have? (Deloitte, October 2019)

Annual report insights 2019: Surveying FTSE reporting (Deloitte, October 2019)

The inclusion imperative for boards (Deloitte, April 2019)

Global Impact Report: Connect for Impact (Deloitte, 2019)

The #MeToo movement has played a pivotal part in drawing attention to an alarming number of instances of professional misconduct and problematic corporate cultures. The conduct of an enterprise's leaders and employees is a window into an enterprise's culture—the combination of values, beliefs, and behaviours that influence how work is done and how people treat one another within the organization. Revelations of misconduct, from sexual harassment to bullying and beyond, can cause significant damage to an organization's brand and reputation. They have led many observers to question the effectiveness of board oversight.

In response, directors are increasingly looking for better ways to monitor corporate culture, understand potential cultural and conduct risks, and to address problems before they spiral out of control. For example, would a potential whistleblower feel safe going to management with information? However, board members don't usually have the opportunity to observe an enterprise's culture on a day-to-day basis, and it can be difficult to perceive a troubled culture at a glance.

Sometimes, management has different priorities, and the best-intentioned corporate policies on #MeToo values and culture that come from the top, and the corresponding good intentions at the bottom, can get lost in the middle, amid day-to-day functions. As well, directors may not understand how to best oversee culture and its related risks.

"Board members don't usually have the opportunity to observe an enterprise's culture on a day-to-day basis.

Some questions the board may wish to ask:

- Should we consider making culture a regular agenda item or discuss culture risk as part of our overall risk oversight process? Are we able to have candid discussions with management about culture and conduct matters? Is management open to these discussions or is it dismissive of cultural matters?
- Have we considered retaining third-party specialists to conduct anonymous surveys to find out how employees feel they are being treated? These specialists can investigate allegations if they arise and report back to the board. They can also ensure that a process is in place for whistleblowers to feel safe if they want to inform management about something they feel needs to be reported.
- Should culture factor into the compensation process? Are the CEO's performance and compensation metrics built around promoting a healthy, diverse culture in which all employees feel they are respected and have an equal opportunity for promotion?
- Do we, as board members, have the ability to track external perceptions of the enterprise and its culture on the web and social media? Have we considered including a summary of progress around culture in the annual report for investors?
- Have we considered establishing a "culture ombudsperson" who helps oversee HR? The ombudsperson could have a dotted line to the board and receive complaints from staff who are reluctant to talk to HR or their manager.
- If your organization was in the headlines tomorrow due to a workplace culture and conduct issue, are you prepared to respond to such a crisis?
- Do employees have a clear mechanism to report incidents—without fear of reprisals?

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Environmental, social, and governance (ESG)

Looking for more guidance?

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When it comes to environmental, social, and governance (ESG) matters, and climate change in particular, there has been a rapid change in the tone of the discussion. Investors are increasingly demanding transparency on organizations' ESG performance and plans to mitigate related risks, while changing consumer behaviour and competition are driving transformative changes in the way business is conducted. In August 2019, Deloitte, along with around 180 other enterprises, was a signatory of a statement on corporate purpose created by the Business Roundtable. The CEOs committed to leading their enterprises for the benefit of all stakeholders and going beyond profit and return on investment.

As the UN General Assembly convened for its Climate Summit last September, an IFAC and ACCA panel discussion about the role of the accounting profession in responding to calls for stricter ESG reporting and sustainability practices was underway nearby. Kevin Dancey, CEO of IFAC and former president and CEO of CPA Canada, described climate change as "one of those big, scary, multi-faceted societal problems that will require serious, coordinated vision and leadership to solve," adding that it will require a healthy dose of honest dialogue.

Climate change is, of course, affecting life on this planet, but it also affects businesses around the globe in various ways, from physical damage to property, supply chain disruptions, rising input costs to regulatory changes and reputational risks. In August, the CSA issued guidance on climate change-related disclosure, since it found that investors are seeking improved disclosure on the material risks, opportunities, financial impacts, and governance processes related to climate change.

Climate change is firmly at the forefront of ESG issues. The World Economic Forum has identified the two top climate change risks we are facing globally: failure of climate change mitigation and adaptation; and extreme weather events. Moreover, climate is as much of an economic issue as it is an environmental and social challenge. There are increasing concerns around shocks to the financial system and how much can be tolerated by our capital markets. There are regulatory pronouncements for banks, insurance companies, pension funds, and the like to conduct credit stress testing of the financial system from climate risks and opportunities stemming from physical risks and transitional risks towards shifting to a low carbon economy. According to most leading scientific reports, the world's carbon budget must reach carbon net zero by 2050. A very deliberate systems-based approach is paramount.

Today, investors' interest in ESG disclosure is growing and some investors highlight that such disclosures are necessary to supplement their investment and voting decisions. They want to know how ESG matters affect the organization's approach to long-term value creation, the nature of strategic and financial risks, and the way the organization intends to manage them. In addition to climate change risk, investors are increasingly looking for disclosure on social impact and supply chain sustainability.

ESG topics may represent material risks and opportunities to an organization or may pose serious threats to the sustained viability of the business. In short, transparency on ESG issues is an essential condition for assessing and managing business risks and opportunities, enabling investors and business stakeholders to make informed decisions.

Excerpt from The Board and ESG, Harvard Law School Forum on Corporate Governance and Financial Regulation

Impacts are increasing and increasingly important. Business activities have both positive and negative impacts on society. Negative impacts include their contribution to climate change and weather-related events, air and water pollution, ecosystem degradation, mistreatment of animals, human rights abuses in supply chains, and potentially unsafe practices and products. Many believe that most negative impacts related to human activities, such as climate change and biodiversity losses, are worsening. Among the most favorable trends is a decline in world poverty; global GDP has risen steadily in the past two decades. Business has also been credited with innovations, job creation, philanthropy, and other contributions. Some organizations have actively embraced and promoted "green" goals and aim to boost the "triple bottom line," which considers people, planet, and profits.

Transparency is the new normal. Trends in ESG reporting indicate a steady move toward greater transparency. Standard-setting organizations, including a number of stock exchanges, have called for enhanced ESG disclosures. Civil organizations and the media regularly track and report on ongoing performance and specific events in terms of industrial accidents, environmental degradation, and impact on human populations. Social media has also become a force for ongoing transparency, and consumers increasingly want to understand what is behind the product they see on a shelf.

Reputation is an indispensable asset. As trust in institutions and the power of traditional advertising have diminished, organizations have come to realize that reputation constitutes a strategic asset and can be directly and indirectly influenced by ESG practices. Although reputation is often viewed mainly as an issue for business-to-consumer companies in developed countries, many business-to-business companies in all markets are affected by greater risks and heightened transparency requirements across the supply chain. In response, many companies are now prioritizing ESG factors internally and among their vendors. These organizations realize that a significant ESG event anywhere in the extended enterprise can damage their reputation.

The workforce cares. Employees want to be proud of where they work and want its purpose, mission, and culture to reflect, or at least not oppose, their values. This is especially true of younger professionals. Corporate value statements and management's cultural messaging may mean little to these workers in the face of negative ESG impacts, which can compromise an organization's ability to attract talent. A favorable ESG profile and an absence of negatives can be an asset, particularly in areas where talent is scarce and competition is strong.

Business value is at risk. ESG issues can take a long time to erupt into risk events. While many environmental risks, such as climate change and water scarcity, have been anticipated for a long time, others emerge rapidly. A recent example includes the plastic backlash that began a year ago, soon after the discovery of the Pacific garbage patch and the subsequent media reporting. Not all ESG risks are long term. Depending on the business model, material and labor sources, evolving regulations, and stakeholder behavior, ESG matters can also present near-term threats to an organization's supply chain, reputation, and shareholder value. Consider the potential impact of child or forced labor in the supply chain, carcinogenic ingredients or conflict minerals in products, or major class-action suits launched over executive decisions or behavior. Given the potential impact on near- and long-term shareholder value, leaders must gauge the full range of factors that generate ESG risks and develop ways to address them.

Excerpt from The Board and ESG, Harvard Law School Forum on Corporate Governance and Financial Regulation, February 2019.

More on this topic:

Developments with respect to Sustainability (Deloitte)

Article on IFRS® Standards and climate-related disclosures (Deloitte, November 2019)

IASB Chair discusses the future of financial reporting (Deloitte, November 2019)

FRC Lab report discussing reporting on climate-related issues (Deloitte, October 2019)

Centre for Financial Reporting

One of the main challenges regarding ESG disclosure is selecting the right framework for the business from among the many standards, metrics, and guidance documents. For instance, the NASDAQ's "ESG Reporting Guide 2.0," released in May 2019, proposes 30 ESG metrics:

Environmental (E)		Social (S)		Corporate governance (G)	
E1	GHG emissions	S1	CEO pay ratio	G1	Board diversity
E2	Emissions intensity	S2	Gender pay ratio	G2	Board independence
E3	Energy usage	S3	Employee turnover	G3	Incentivized pay
E4	Energy intensity	S4	Gender diversity	G4	Collective bargaining
E5	Energy mix	S5	Temporary worker ratio	G5	Supplier code of conduct
E6	Water usage	S6	Non-discrimination	G6	Ethics and anti-corruption
E7	Environmental operations	S7	Injury rate	G7	Data privacy
E8	Climate oversight/board	S8	Global health and safety	G8	ESG reporting
E9	Climate oversight/management	S9	Child and forced labor	G9	Disclosure practices
E10	Climate risk mitigation	S10	Human rights	G10	External assurance

Source: ESG reporting guide 2.0, NASDAQ, page 13, May 2019

When it's done right, reporting on ESG issues is a useful tool for communicating how an organization is evaluating a broader universe of risks and opportunities, and how it is investing in social and environmental resources and capital to derive future value or mitigate risk. A recent post in the Harvard Law Forum on Corporate Governance and Financial Regulation, The Board and ESG, by Olivier Jan from Deloitte, outlines the evolving ESG trends and practices for boards to note.

> "ESG matters now carry significant reputational weight with the public, investors, regulators, and other stakeholders. Boards should be prepared to provide appropriate oversight in this area.

Some questions the board may wish to ask:

- Have we, and has management, identified the ESG matters that are most material to the organization's business and its key stakeholders?
- Has our company identified the ESG risks that are most important to our business operations? Are these risks incorporated into our broader enterprise risk management system?
- What questions are shareholders, regulators, employees, customers, or other stakeholders asking about long-term strategy and the potential impact of ESG risks on corporate performance?
- Are we satisfied that there are appropriate policies and procedures in place to enable the organization to assess, monitor, and manage ESG risks?
- Has management identified whether—and how—ESG issues should be incorporated into processes such as strategic or operational planning, risk management, crisis planning, communications, or budgeting?
- Does management provide us with appropriate, regular updates regarding ESG matters? Is ESG on the board's agenda?
- Should ESG-specific metrics be included in the performance evaluation process and/or incentive plan design? If such metrics have already been adopted, are they weighted enough to be meaningful?
- Is the organization balancing short-term business interests with long-term business sustainability? How do we determine what time horizon to use in setting strategy and making investments?
- Does management follow a voluntary disclosure framework for our organization's climate change-related disclosures, such as the global reporting initiative (GRI) framework? Are disclosure practices in line with those of our industry and our peers? If not, what is management's rationale?
- Is management aware of material climate-related physical and transition risks and opportunities for business? Is there a process in place to effectively identify, assess, and manage these risks and opportunities? Has management quantified the potential impact of climate change-related risks on the business? Is this quantification clear and reasonable?

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Diversity on boards and in executive officer positions

Looking for more guidance?

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More on this topic:

Canadian securities regulators release data regarding women on boards and in executive officer positions (Deloitte, October 2019)

Being intentional about achieving board diversity (NACD, September/October 2019)

New CBCA diversity disclosure requirements confirmed (Deloitte, July 2019)

Diversity in the boardroom: Filling in the missing pieces (Deloitte, April 2019)

Centre for Financial Reporting

There has been a change to diversity disclosure requirements in Canada. New regulations, in effect as of January 2020, require publicly listed Canada Business Corporations Act (CBCA) corporations to provide certain information about board and executive officer diversity policies and statistics. Although diversity disclosure requirements have existed since 2018, the requirements have broadened the meaning of diversity beyond gender and have expanded the number of corporations that will be required to provide such information. The new rules will apply to all CBCA reporting issuers, including issuers listed on the Toronto Stock Exchange, TSX Venture Exchange, and Canadian Securities Exchange.

It is believed that Canada is the first jurisdiction in the world to mandate diversity disclosure with respect to specific personal characteristics in addition to gender. Shareholders will now be provided with information on a corporation's policies and practices related to diversity on the board and within senior management, including not only the number and percentage of members who are women, but who are Aboriginal people, members of visible minorities, and persons with disabilities. The "comply or explain" approach puts the responsibility on Canada's corporations to explain to shareholders how they are advancing the issue of greater board and management diversity.

In October 2019, the CSA released some new data regarding women on boards. The disclosure data of 641 issuers was reviewed; participating jurisdictions included Alberta, Manitoba, New Brunswick, Nova Scotia, Ontario, Quebec, and Saskatchewan.

The total number of board seats occupied by women

17%	11%
Increase 2019	Increase 2015

Number of women on boards

73%	49%
Had at least one woman on their board	Increase from 2015

Source: CSA Multilateral Staff Notice 58-311, Report on Fifth Staff Review of Disclosure Regarding Women on Boards and in Executive Officer Positions

Diverse board and senior management candidates often come from outside of established networks and are therefore less known to current board members and search firms. As current board members likely have never worked with these candidates before, it's important that directors gain firsthand knowledge of women and minority groups by going beyond their existing relationships to consider less familiar candidates. The key is to build a diverse pipeline, and it should be a team effort to create an inclusive environment.

> "The key is to build a diverse pipeline, and it should be a team effort to create an inclusive environment.

Some questions the board may wish to ask:

- What is our active working definition for diversity and inclusion and what is our vision for an inclusive culture? How does the business strategy reflect that?
- Does the enterprise have a written board policy relating to the identification and nomination of directors who are members of the designated groups? Does the policy summarize its objectives and outline measures being taken to implement the new requirements? Does the written policy mandate progress reports?
- Does the selection process mandate, right from the start, that the pool of candidates be diverse?
- Do we make it a habit to sponsor and mentor diverse leaders both within the enterprise and in our extended networks? Does the organization have mentorship programs that increase exposure for diverse groups to executive decision-making circles? Is it helping build a pipeline of diverse candidates ready to fill top positions?
- Has the board and management reviewed regulator surveys of disclosures made by the organization regarding diversity in its director or executive officer positions? How does it compare with other organizations in its industry?

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Transformation

Transformation in the digital age

Looking for more guidance?

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More on this topic:

Tech Trends 2020 (Deloitte, February 2020)

Manage data: Cultivating data for insights (Deloitte, 2019)

Canada's AI Imperative: Overcoming risks, building trust (Deloitte, 2019)

Refocus your robotic process automation lens (Deloitte, 2019)

Digital transformation is the integration of digital technology throughout a business, fundamentally changing how it operates and delivers value to customers. And while there once was a time when an organization could wait and see what it should adopt, today the need for transformation is critical and urgent. Organizations no longer have the luxury of waiting or doing too little.

In what has been called the Fourth Industrial Revolution, today's emerging technologies are digital, cloud, artificial intelligence (AI), robotic process automation (RPA), augmented reality, and the Internet of Things. They are boosting enterprises' efficiencies at levels not seen before and reshaping their operating models. These technologies are the reason we are in a highly disruptive age, but successful digital companies are moving past the technology to consider how people aspects from mindset to operating models need to also change.

The transformation that enterprises must undergo doesn't involve only selecting and harnessing new technologies to gain competitive advantage—a critical part is culture. Successfully transformed organizations first lay the groundwork by building a culture that is more adaptable to change. They drive digital efforts by cultivating values such as risk-taking, collaboration, agility, and continuous learning.

Boards need to challenge their leadership teams to make sure that their companies are redefining a new north star–aspiration that is more purpose driven and impactful. Then they must consider how mindset, culture, leadership, competencies/capabilities, and operating models need to also evolve to be competitive in the digital age.

Boards aren't always equipped to identify what new technology is good for their organization. So how do you make sure you pick the right new thing? An internal enterprise-wide task force can be built, or an enterprise could use external resources, taking on independent advisors and specialists to introduce to them what is suitable for the enterprise, and to compare them with their peers. It's crucial that enterprises choose the right advisor or specialist.

Another major consideration is making sure your technology modernization effort is paired with a modernization of your corporate reporting. Internal controls should take into account emerging technologies; the board's audit committees should advance their oversight of and involvement with these technologies; and enterprises should discuss their strategy in terms of how they will mitigate risks arising from digital transformation.

Last but not least, in these times of unprecedented data collection by enterprises, is the importance of data management. It is imperative to take intelligent steps to master an enterprise's wealth of data in terms of its safekeeping, governance of access rights, and creation of a code of conduct around its use. But beyond managing and securing data is harnessing it, too. Using data and analytics to gather insights can inform better decisions, thus potentially gaining value for the enterprise. A CDO (chief data officer) can identify and evaluate data assets and, with IT support, build or acquire the necessary platforms and competencies.

> "In this 'Fourth Industrial Revolution,' today's emerging technologies are boosting enterprises' efficiencies and reshaping businesses and their operating models. We now understand it's really not about technology—**people** are the real key to digital transformation.

Some questions the board may wish to ask:

- Is there buy-in at our level that digital transformation is necessary? Does leadership empower employees to think creatively and collaboratively?
- Has an executive sponsor, with the appropriate competency and authority, been identified to champion and lead the project? Is the organization's digital vision accountable and measurable?
- Are we considering the key people aspects (mindset, culture, leadership, capabilities, operational model, etc.) in our digital transformation journey?
- Are the leaders leading by example by infusing new behaviour, culture, and leadership into the organization?
- Have education and training programs been developed to help management, business owners, and the internal audit function gain sufficient understanding of how new technology affects risk assessment, and to determine which new or modified controls are needed for monitoring?
- Do we have a program to upskill and add new capabilities to our ecosystem to enable our people, customers, and partners to be successful in the digital age?
- Will the new technology contribute to a business growth target, provide a competitive benefit, address an existing process risk, or reduce costs? Does it indicate a change in the enterprise's business model in ways that create new financial reporting risks?
- Has management identified third parties that are integral to the function of the emerging technology? If so, are risk management practices of the third party sufficient to adequately address the technology?
- What controls are in place to help ensure that those charged with oversight would be informed if a cybersecurity breach occurred?
- Have steps been taken to manage data not only to keep it secure but to harness it with an aim to adding value to the enterprise?

Cybersecurity risks and incidents

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More on this topic:

Cybersecurity: Is it on your radar? (CPA Canada, November 2019)

20 questions directors should ask about cybersecurity (CPA Canada, October 2019)

Computing ethics are a board concern (Directors & Boards, October 2019)

The new world of cyber risk (Deloitte, September 2019)

Centre for Financial Reporting

As we all see and as we experience firsthand every day—technological breakthroughs and heightened connectivity are bringing cyber to the forefront of our work and daily lives more than ever before. We're seeing information technology and operational technology converging, and with this heightened connectivity brings complexity. Managing cyber everywhere is about protecting what matters – data, infrastructure, applications, core business processes, critical operational functions, supply chain, etc. Without a doubt, today, cyber is everywhere.

Traditionally, cyber has been viewed as a means to protect information and thus control has been relegated to the IT function. However, this model is no longer sufficient as organizations rely on digital technologies and digitally connected products. These technologies coupled with the Internet of Things have significantly increased the attack surface across the organizational and consumer spheres. We've entered into an era of complexity and cyber is everywhere.

In the era of complexity, criminals and other malicious cyber threat actors, who know no borders, take advantage of enterprises' security gaps, low cybersecurity awareness, and technological developments in an effort to compromise systems. They steal personal and financial information, intellectual property, and trade secrets. Often, sophisticated criminals exploit vulnerabilities and "disrupt" and sometimes destroy the infrastructure that we rely on for essential services and our way of life.

Just about every enterprise will experience a cyber breach, which could be data related. Their clients know this too, and they expect enterprises they've entrusted with their data to be prepared to respond effectively and quickly. Indeed, PIPEDA—Canada's Personal Information Protection and Electronic Documents Act—updated in 2019, mandates organizations to have proper breach-preparation measures in place and to keep a record of all breaches. The required response plan includes, among other factors, the speedy notification of customers of any breach that's likely to result in high privacy risk. (A March 2019 report by Audit Analytics showed that it took organizations an average of 44 days after a breach was discovered to report it.) Customers should be given top priority as they are an organization's most important asset. Failing to manage customer impact could trigger regulatory fines, customer loss, and damage to the brand's reputation.

There is also a new level of focus on ethics and values as regulatory guidelines fail. Many of the technical, data, and customer engagement decisions that enterprises make in the next five years will take them into uncharted territory. Previously, when adopting a new technology, releasing a new product, or testing a new business model, it was often good enough to have the legal team review applicable laws and set guidelines. Now, as legal guidelines don't exist for many of the initiatives the enterprises will soon face, they will have to facilitate conversations to determine how ethical implications, customer and employee expectations, and corporate values guide their decisions. Enterprises have an ethical responsibility when it comes to technology, including but not limited to protecting customers' privacy. To ensure this, there should be a technology code of ethics in place for employees.

Days between discovery of breach and disclosure of breach

26
Median

367
Maximum

It took companies, on average, 44 days to disclose the breach

Source: Audit Analytics, Trends in Cybersecurity Breach Disclosures (March 2019)

Hackers generally seek nine pieces of information when attacking a company's systems. As shown below, the top two pieces of data compromised are personal information and credit card numbers. In many attacks, more than one category of information is stolen. In other words, many of the attacks that were successful in illegally obtaining financial information also gained access to names and emails.

	# of breaches	% of breaches
Name	225	45%
Credit card	142	29%
Email	140	28%
Address	111	22%
Password	109	22%
SSN	97	19%
Username	68	14%
Intellectual property	26	5%
Bank account	23	5%

Source: Audit Analytics, Trends in Cybersecurity Breach Disclosures (March 2019)

As per PIPEDA, organizations must report security breaches that cause a "real risk of significant harm," inform affected individuals, and keep security breach records under their control for two years. Deloitte experts recommend that enterprises consider taking these additional steps:

1. Ensure they have the right cyber strategy and the right team to implement the strategy.
2. Establish a coordinated governance and risk model.
3. Align cyber risk with operational risk frameworks and develop a shared understanding of materiality considerations.
4. Understand disclosure obligations under federal and local laws, and establish and maintain appropriate and effective disclosure controls for cybersecurity risk and incidents.
5. Examine and update insider trading policies and procedures.
6. Raise C-suite and board awareness of the enterprise's obligations, and assess and test incident management processes, including through cyber war-gaming.
7. Implement preventative and detective control and strengthen cyber resiliency should those controls fail.
8. Remain vigilant over potential side-effects and risks, such as talent shortages and cyber threats to both information technology and operations technology.
9. Cultivate both internal and external communities of learning.
10. Inventory your cyber assets. Identify crown jewels and ensure they are properly protected.

> "Enterprises have an ethical responsibility when it comes to technology, including but not limited to protecting customers' privacy.

Some questions the board may wish to ask:

- Is there a company-wide technology code of ethics and an overall code of conduct in place?
- How secure are our organization's information and operations technology systems? What is our organization doing to protect itself from a cyberattack? Is there any aspect of the organization's operations (e.g., its industry sector, ownership of specific assets, nature of its operations, etc.) that makes it particularly vulnerable to a cyberattack?
- What controls are in place to safeguard against potential insider threats? How can the organization legally monitor employees who have authorized access to enterprise data to ensure their proper use of that data?
- Is the organization associated with any third parties that might expose it to cyber risks? What steps have been taken to mitigate those risks?
- Has the organization put a dollar figure on a potential security breach to identify its true cost? Potential costs include immediate ones, such as hiring forensics professionals to stem the problem, possible increases in insurance premiums, fees for a PR firm to manage the crisis, and legal fees.
- Has the organization put in place an incident management and disaster recovery plan? Do the organization's insurance policies provide protection against a cybersecurity attack? If so, to what extent would that insurance cover the damages caused?
- Has the organization ever been a target of a cyberattack? How serious was that attack? Did any attack—individually or in aggregate—have a material impact? What information was disclosed about material attacks in accordance with securities legislation?
- Has the organization performed cyber incident response simulations or war gaming exercises? Are lessons learned incorporated into incident response playbooks?

Blockchain technology

Looking for more guidance?

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More on this topic:

Investigating the impact of global stablecoins (G7 Working Group on Stablecoins, October 2019)

Canada pilots blockchain staff records, (Global Government Forum, June 2019)

Demystifying blockchain for controllers: Is a revolution coming? (Deloitte, May 2019)

CFO Insights: Unleashing blockchain in finance (Deloitte, March 2019)

Centre for Financial Reporting

Today, we share information through decentralized online platforms using the "internet." But when it comes to transferring value–e.g., money, ownership rights, intellectual property, etc.,–we are usually forced to fall back on old-fashioned, centralized institutions or establishments like banks or government agencies. Even online payment methods require integration with bank accounts or credit cards to be useful.

Now enter Blockchain–a distributed ledger that allows digital assets to be transacted in real time, in an immutable manner. It disintermediates these centralized institutions by establishing trust and enabling full transparency/auditability for all participants.

Blockchain has emerged and has come to be recognized globally as a transformational pragmatic technology, even though it hasn't reached its full potential yet. Momentum has already begun shifting from "blockchain tourism" to "blockchain-building." Today, blockchain is garnering headlines once again, this time for the vast ecosystem of cross-industry use cases emerging around it.

Deloitte's 2019 Global Blockchain Survey reveals that a majority of organizations consider blockchain to be one of their top five critical and strategic priorities of the year. This indicates that there is a growing awareness of the benefits of this technology and the willingness to make significant investments towards building blockchain capabilities that will enable organizations to stay at par with all their peers in the market.

Organizations and tech-savvy executives believe that blockchain is highly scalable and would eventually achieve mainstream adoption. What we have seen in 2019 is the continuing evolution of blockchain from a capable yet underdeveloped technology into a more refined and mature technology poised to deliver on its initial promise to disrupt.

Blockchain has been growing phenomenally with a forecasted compound annual growth rate (CAGR) of 80.25% between 2018 and 2025. By 2023, the blockchain market is likely to reach US$23 billion, with the Asia-Pacific region registering the highest CAGR of 90.4% during this period.[2] The financial services industry has been the first to take massive steps towards blockchain adoption. The Fintech sector is currently the blockchain development leader. It is closely followed by technology, media and telecommunications, life sciences and health care, and government. These sectors are expanding and diversifying their blockchain initiatives.

Owing to the newness and potential of blockchain, a few boards are skeptical about making a huge investment in it. Some of the organizational barriers to increasing adoption and scale in blockchain are:

- Implementation–replacing or adapting the existing legacy systems
- Regulatory issues
- Security threats–potential safety/privacy breach
- Lack of in-house capabilities–in-house skill-set, capability, and understanding of the new technology
- Uncertain ROI–since there is no benchmark or history for reference

2 Source: ReportLinker, The global blockchain market size is expected to grow from USD 1.2 billion in 2018 to USD 23.3 billion by 2023, at a Compound Annual Growth Rate (CAGR) of 80.2%, December 2018

> "What we have seen in 2019 is the continuing evolution of blockchain from a capable yet underdeveloped technology into a more refined and mature technology poised to deliver on its initial promise to disrupt.

Directors and senior management need to understand the broader implications of blockchain within their organizations. Boards are now less concerned about whether the technology will work and have begun to focus on what business models it might disrupt. They should no longer ask a single question about blockchain technology but, rather, a broad set of questions reflecting the role blockchain can play within their organization.

Organizations should look to standardize the technology, talent, and platforms that would drive future initiatives and, further, to coordinate and integrate multiple blockchains working together across a value chain.

The successful adoption of any new technology is dependent on the appropriate management of the associated risks. This is especially true when that technology is part of the organization's core infrastructure, as is the case with blockchain. Additionally, it's important to understand the evolution of regulatory guidance and its implications. For example, the Financial Industry Regulatory Authority has shared operational and regulatory considerations for developing use cases within capital markets. Organizations should work to address these regulatory requirements in their blockchain-based business models and establish a robust risk management strategy, governance, and controls framework.

Some questions the board may wish to ask:

- How are blockchain-enabled processes changing the way my sector does business?
- How can blockchain reshape my industry? What are my long-term objectives and strategies?
- Does blockchain create the potential for new market ecosystems, and what role can we play?
- How do we leverage the inherently open nature of blockchain?
- What opportunities does blockchain generate for co-creating new markets?
- Where are my biggest blockchain blind spots?

Transparency

- Transparency and timely information
- Significant accounting policies
- Significant judgments and estimate uncertainty
- Non-GAAP financial measures
- Key audit matters

Transparency and timely information

Looking for more guidance?

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More on this topic:

Audit Committee Transparency Barometer (CAQ, November 2019)

Overcoming disclosure overload and achieving greater disclosure effectiveness (The CPA Journal, November 2019)

CEO pay ratio: Leading indicator of broader human resource matters? (Deloitte, July 2019)

SEC proposes to ease qualifications for non-accelerated filer status (Deloitte, May 2019)

Resilience in the face of crisis (Deloitte Directors' Series, October 2019)

Centre for Financial Reporting

The need to be transparent and timely has never been more important. Regulators are helping facilitate this on a number of fronts. One is disclosure overload: both the FASB and SEC are proposing that redundant, immaterial disclosure requirements be reduced in order to improve clarity. Also, in December 2018, the SEC issued a request for comment on quarterly reports and earning releases. It is looking for input on how it can reduce burdens on enterprises that do quarterly reporting while maintaining the effectiveness of disclosure and protections for investors. It is also seeking comment about whether the existing system fosters an overly short-term focus by management and markets. Information about internal controls is also in focus, as the SEC recently said that simply disclosing ineffective internal controls isn't sufficient, but that firms need to also demonstrate what they are doing to fix the problems.

In the meantime, the SEC proposed, in May 2019, amendments to the accelerated filer and large accelerated filer definitions. The proposed amendments "...would reduce costs for certain lower-revenue enterprises by more appropriately tailoring the types of enterprises that are categorized as accelerated and large accelerated filers while maintaining effective investor protections."

As a result of the proposed amendments, reporting companies with less than $100 million in revenues would be considered smaller reporting companies (SRCs) and would not be required to obtain an attestation of their internal control over financial reporting (ICFR) from an independent outside auditor.

If the proposed rule is finalized, certain SRCs would newly qualify as non-accelerated filers and would no longer be subject to auditor attestation of ICFR under SOX Section 404(b). However, the proposed rule would not relieve management of its obligation to assess ICFR, nor would it relieve an independent auditor of its obligation to consider ICFR in the performance of its financial statement audit of an issuer.

The purpose of an organization's financial reports is to help users understand the financial position and performance of the business. Using standardized "boiler plate" wording should be avoided; instead, narratives should be specific and relevant to the organization.

Since financial reporting is a dynamic process, the need for particular disclosures can change. It is imperative that issuers keep up to date with financial reporting standard developments and ensure their business activities are disclosed in a coherent and transparent manner.

> "The SEC is seeking comment about whether the existing financial reporting ecosystem fosters an overly short-term focus by management and markets.

Some questions the board may wish to ask:

- Is the information presented in the financial reporting and continuous disclosure documents consistent with our knowledge of the organization and its overall performance for the year?
- Based on our knowledge, are risk disclosures and segment reporting consistent with internal reporting?
- Have boilerplate disclosures been removed and are the disclosures tailored to discussions about the organization's circumstances? Do the disclosures truly tell the organization's story?
- Are the financial statements logically structured and easy to navigate? Are critical note disclosures, including accounting policies, prioritized?
- Have all of the disclosure requirements contained in the relevant GAAP and securities regulations been considered?
- Does the enterprise intend to continue or start providing information about their control environment?

Significant accounting policies

Looking for more guidance?

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More on this topic:

Clearly IFRS — IASB proposes amendments with regard to the disclosure of accounting policies (Deloitte, September 2019)

SEC proposes to modernize disclosures of business, legal proceedings, and risk factors under Regulation S-K. U.S. Securities and Exchange Commission (SEC, August 2019)

Centre for Financial Reporting

Accounting policies must be in accordance with International Financial Reporting Standards (IFRS) or another appropriate framework, such as US GAAP for SEC registrants. Board members should consider whether these are appropriate given the specific facts and circumstances that relate to the organization.

Users of financial statements have been vocal in recent years, asking for more useful and transparent information. They want to understand how accounting standards have been applied. Securities regulators and other users have regularly critiqued the volume of boilerplate and legalistic verbiage. Users want more tailored information so they can make informed decisions.

Securities regulators have launched significant game-changing initiatives to address these concerns. In August 2019, the SEC proposed rule amendments to modernize the description of a business, explanations of legal proceedings, and risk-factor disclosures that registrants are required to make pursuant to Regulation S-K. These proposals encourage companies to discuss only relevant risk factors rather than list all potential, even remote, risk factors. They also improve the readability of disclosure documents and discourage repetition and disclosure of information that is not material.

The IASB recently issued proposals to eliminate accounting policies that duplicate the requirements of an IFRS standard and those that describe situations that do not require the exercise of judgment as these disclosures are unlikely to influence the decisions that primary users of financial statements make.

> “Securities regulators and accounting standard setters have launched significant game-changing initiatives.

Some questions the board may wish to ask:

- Are the accounting policies clear, concise, and complete?
- Are the organization's accounting policies appropriate? Are they consistent with industry practice? Do they fairly present the organization's financial position, financial performance, and cash flows?
- Do the accounting policies appropriately articulate significant judgments and estimates?
- Are only relevant risk factors disclosed rather than all potential, even if remote, factors?
- What matters has the independent auditor raised and what was the outcome of these matters? How were any disagreements with the independent auditor resolved?
- Has the audit committee engaged with management and the independent auditor to understand the process for adopting new accounting standards?
- Have there been any significant new judgments, estimates, or disclosure requirements?
- Are there changes that should be implemented to assist with the adoption of future standards?

Significant judgments and estimate uncertainty

Looking for more guidance?

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Centre for Financial Reporting

The preparation of financial statements may require management to make estimates when the outcome of a particular matter is uncertain. Accounting estimates often require internal controls that differ from the internal control over financial reporting that is applied to systematically processed, recurring transactions and are, therefore, subject to increased risk of fraud due to the judgments involved. Board members should carefully consider the information on accounting estimates and satisfy themselves that the judgments made by management are reasonable.

> "Board members should carefully consider the information on accounting judgments and estimates as they are subject to increased risk of manipulation.

Some questions the board may wish to ask:

- Has management provided us with information on the significant accounting judgments and estimates made in preparing the financial statements?
- Have we considered any triggers that might motivate the manipulation of the financial statements, such as management bonus schemes, covenants, etc.? Are there adequate internal controls over financial reporting in place to protect against manipulation?
- Are the assumptions applied to estimates made by management consistent with our understanding of the business and our understanding of the board's and management's intent?
- Has management considered estimates involved in the adoption of new accounting standards? For example, has management provided us with the key judgments and estimates arising from the adoption of IFRS 16 in areas such as lease identification, lease term, and measurement of the lease liability and right-of-use asset?
- Have there been any impairments that have not been recognized in the financial statements?
- Have we considered whether key models should be subject to independent analysis and verification by internal audit or third-party specialists?
- Have we considered management's retrospective review of assumptions and determined the accuracy of management's assumptions in the past?
- Do the financial statements describe all significant judgments and major sources of estimation uncertainty? Have disclosures been made for:
  - Judgments with the most significant effect on the amounts recognized in the financial statements?
  - Assumptions about the future and other major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year?
  - Sensitivities or ranges of outcomes, so that users of the financial statements can fully understand the potential effect of estimates made?
- Are significant judgments disclosed separately from major sources of estimation uncertainty? Are disclosures provided in one place, either in their entirety or with clear cross-reference to where further information is provided?
- Do the disclosures avoid mere repetition of accounting policies and generic statements without quantification and focus on how particular decisions or assumptions might affect the entity's results and financial position?

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Non-GAAP financial measures

Looking for more guidance?

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More on this topic:

CSA Looking for Feedback on Revised Non-GAAP Financial Measures Securities Law: Views from Deloitte's Securities Centre of Excellence
(Deloitte, February 2020)

Use of Non-GAAP measures in executive compensation
(CCGG, December 2019)

CSA Staff Notice 52-306 (Revised), Non-GAAP Financial Measures
(CSA, January 2016)

Centre for Financial Reporting

Most companies prominently feature non-GAAP financial measures in their continuous disclosure documents. Although the use of non-GAAP measures in TSX 60 members' regulatory filings has declined from 80 percent to 70 percent and is now in line with members of the S&P 500, more than 95 percent of TSX 60 members rely on a non-GAAP metric to report their performance (source: *Non-GAAP Update: Digging into One-Time Items* (Veritas, November 2019)).

In September 2018, the Canadian Securities Administrators (CSA) published for comment Proposed National Instrument 52-112 Non-GAAP and Other Financial Measures Disclosure and related Companion Policy ("52-112" or "Proposed Instrument"), which is intended to replace the existing CSA Staff Notice 52-306 (Revised), Non-GAAP Financial Measures ("SN 52-306") 52-112 was published for a second 90-day comment period on February 13, 2020.

As highlighted in a US-based study, EBITDA and adjusted earnings continue to be the most prominent non-GAAP financial measure presented:

Reporting year	# of companies presenting non-GAAP metrics	# of companies not presenting non-GAAP metrics	% of filers using non-GAAP	# of metrics per filing
1996	162	113	59%	2.35
2006	331	106	76%	3.47
2016	462	19	96%	7.45

Source: Audit Analytics, Long-Term Trends in Non-GAAP Disclosures: A Three-Year Overview

The authors of another US study, "Accounting reporting complexity and non-GAAP earnings disclosure," believe that the proliferation of non-GAAP earnings measures reflects the increasing complexity of GAAP accounting. Their findings indicate that managers make adjustments in an effort to decrease this complexity and that investors perceive non-GAAP measures as more informative when accounting reporting complexity is high. The authors suggest that further simplification of accounting standards might be necessary.

Concerns have been raised internationally around the potential for non-GAAP measures to be misleading and lacking transparency. Several initiatives have been launched to address these concerns.

The issuance of 52-112 is an effort to improve the quality of information provided to investors. Under the Proposed Instrument, the definition of a non-GAAP financial measure was updated and defined as "a financial measure that is not disclosed in the primary financial statements or presented in the financial statements and is not a disaggregation of a line item presented in the primary financial statements." In addition, the Proposed Instrument introduced concepts such as segment measures, capital management measures, and supplementary financial measures, each with its own disclosure requirements. Comments on the Proposed Instrument are due on May 13, 2020.

> "In plain language, a non-GAAP financial measure would include or exclude at least one amount that is excluded from or included in the most comparable GAAP financial measure.

The SEC also continues to focus on disclosures of Non-GAAP financial measures, including recent guidance on key performance indicators. This publication states that companies should consider "the need to include such further material information, if any, as may be necessary in order to make the presentation of the metric, in light of the circumstances under which is it presented, not misleading." The publication goes on to discuss the types of additional disclosures that would be expected. These disclosures are broadly similar to those found in CSA Staff Notice 52-306.

The IASB's Primary Financial Statements project is considering possible changes to the structure and content of primary financial statements. The IASB is considering introducing management performance measures directly onto the face of the financial statements. It is hoped that this will contribute to reducing the need for companies to report non-GAAP measures outside the financial statements.

In a speech by Sue Lloyd, International Accounting Standards Board ("IASB") Vice-Chair, she states:

"On balance, we have decided that the IASB has a role to play here and that use of management performance measures needs to be anchored in some way to the IFRS financial statements. So, in addition to the IFRS-specified subtotals I just talked about, we are proposing to require a new footnote disclosure related to company-specific profit subtotals—we call the non-GAAP measures we are focusing on management performance measures, or MPMs for short.

Not every jurisdiction in the world has SEC-like regulation over non-GAAP measures. This footnote would explain why management believes the subtotal is a relevant measure of performance, explain how it is calculated, and provide a reconciliation to the closest IFRS-specified subtotal. It also has the advantage of providing discipline by bringing this information into the scope of the financial statements."

In its Exposure Draft *General Presentation and Disclosures* issued in December 2019, the IASB proposes the following: (i) introduction of defined subtotals and categories in the statement of profit or loss; (ii) introduction of requirements to improve aggregation and disaggregation; (iii) introduction of Management Performance Measures (MPMs) and accompanying disclosures in financial statements; and (iv) introduction of targeted improvements to the statement of cash flows.

Below is an illustrative statement of profit or loss included in the IASB's Exposure Draft.

Statement of profit or loss
XYZ Group—Statement of profit or loss for the year ended December 31, 20X2

(In currency units)

	Note	20X2	20X1
Revenue	2	347,000	335,000
Cost of goods sold	2	(237,100)	(219,900)
Gross profit		**109,900**	**115,100**
Other income[1]		3,800	4,100
Selling expenses		(28,900)	(27,350)
Research and development expenses		(13,850)	(22,400)
General and administrative expenses	2	(25,180)	(25,060)
Impairment losses on trade receivables		(4,500)	(3,800)
Operating profit		**41,270**	**40,590**
Share of profit or loss of integral associates and joint ventures		(600)	2,000
Gains on disposals of integral associates and joint ventures		–	2,200
Operating profit and income and expenses from integral associates and joint ventures		**40,670**	**44,790**
Share of profit or loss of non-integral associates and joint ventures		3,380	1,000
Dividend income		3,550	3,210
Profit before financing and income tax		**47,600**	**49,000**
Expenses from financing activities	2	(3,800)	(4,500)
Unwinding of discount on provisions		(3,000)	(2,500)
Profit before tax		**40,800**	**42,000**

Source for this table: IFRS® Standards Exposure Draft ED/2019/7 Illustrative Examples, December 2019

Note 2—Management performance measures and unusual income and expenses
The group uses three management performance measures as defined in (draft) IFRS X in its financial communications with users of financial statements. The three measures are 'adjusted operating profit', 'adjusted net profit' and 'adjusted equity holders' profit of parent.

These management performance measures provide management's view of an aspect of the group's financial performance. They are not specified by IFRS standards and therefore may not be comparable to apparently similar measures used by other entities. They are provided to complement measures of performance specified by IFRS standards, and are not intended to be a substitute for measures specified by IFRS standards.

In December 2018, the Accounting Standards Board (AcSB) released its *Framework for Reporting Performance Measures* ("Framework"). This document was aimed at enhancing the usefulness and transparency of performance measures (including non-GAAP measures as defined in the Framework, other financial measures and non-financial/operational measures) reported outside the financial statements. The Framework provides guidance on how an enterprise can select, develop, and report a performance measure.

The application of the Framework is voluntary and can be applied by any type of entity (i.e., public, private, or not-for-profit) reporting under any accounting framework. The Framework defines a performance measure, that includes non-GAAP financial measures (note that the definition may not be aligned with Canadian securities regulations, current, or the Proposed Instrument), another financial measure, and a non-financial measure or operational measure.

Some questions the board may wish to ask:

- Is there a policy regarding the determination of non-GAAP measures? Are the measures consistently prepared from period to period in accordance with that policy? Are they comparable to those of its peers? Is the audit committee involved in the oversight of the identification and disclosure of non-GAAP measures?
- Has the audit committee and management been directed to focus on the use of non-GAAP financial measures? More specifically, has the organization:
  - Put itself in the shoes of investors when evaluating whether the non-GAAP financial measures and related disclosures align with its overall strategy and performance?
  - Documented the criteria for determining when to change the composition of a non-GAAP financial measure?
  - Adopted practices encouraging a clear description of complex accounting standards rather than defaulting to the use of non-GAAP measures to address this complexity?
  - Ensured that the disclosure controls, procedures, and internal control over financial reporting, as applicable, address non-GAAP measures?
- Has the CSA's SN 52-306 been considered for all non-GAAP and other financial measures, including those in press releases, the MD&A, prospectus filings, websites, and marketing materials?
- Is there a clear rationale behind the use of each non-GAAP financial measure and has this purpose been sufficiently explained in the document?
- For each non-GAAP financial measure, is there a reconciliation to the most directly comparable GAAP measure? Is the approach to reporting adjustments transparent and comparable between reporting periods? Are GAAP measures disclosed equally to, or more prominently than, non-GAAP financial measures? Is the measure misleading or prohibited?

Key audit matters

Looking for more guidance?

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More on this topic:

Basis for Conclusions – CAS 700, Reporting on Audited Financial Statements (Deloitte, December 2019)

PCAOB Critical Audit Matters Spotlight (PCAOB, December 2019)

Update – AASB expands key audit matter reporting (Deloitte, November 2019)

Critical audit matters: What firms are reporting (Deloitte, October 2019)

Centre for Financial Reporting

The Canadian Auditing and Assurance Standards Board's (AASB) Basis for Conclusions issued in December 2019 requires communication of key audit matters (KAMs) for entities listed on the Toronto Stock Exchange, excluding listed entities required to comply with National Instrument 81-106, *Investment Fund Continuous Disclosure*, for periods ending on or after December 15, 2020; and other listed entities, excluding listed entities required to comply with NI 81-106, for periods ending on or after December 15, 2022.

In the United States, the disclosure of critical audit matters (CAMs), as required by AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, became effective for large accelerated SEC filers with fiscal years ending on or after June 30, 2019. So far, as of February 12, 2020, approximately 400 audit opinions filed included one or more CAMs.[3] We expect that trends with CAMs in the United States will be similar to KAMs in Canada. In an October 2019 analysis released by Audit Analytics (see below, "An update on critical audit matters (CAMs)"), 22 percent of CAMs address asset impairment and recoverability, 21 percent relate to revenue recognition, 17 percent involve business combinations, 13 percent address taxes, and six percent relate to contingent liabilities.

Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit. They are selected from the matters communicated to the audit committee. To determine what constitutes a KAM, the auditor considers:

- Areas of higher assessed risk of material misstatement or significant risks;
- Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates identified as having high estimation uncertainty; and
- The effect on the audit of significant events or transactions that occurred during the period.

In the auditor's report, the auditor is required to (i) communicate the KAM identified and why it is considered a KAM, (ii) describe how the KAM was addressed in the audit, and (iii) cross-reference the KAM to the related financial statement disclosures.

A smooth transition will be facilitated by the timely identification and communication of key audit matters between the external auditor, management, and the audit committee; these parties are key to strong financial reporting and governance.

3 Source: Audit Analytics, No Critical Audit Matters Identified for Redfin Corp., February 14, 2020

> "Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit.

Some questions the board may wish to ask:

- What matters do we expect to be considered a KAM?
- Do the disclosures in the financial statements include all relevant information?
- Does our auditor have experience with the US standard? Has the auditor reviewed US examples to assess readiness?
- How do these key audit matters compare with those identified for other enterprises in our industry?
- How will management and the audit committee engage with the auditor as matters are identified, and as the auditor's description of the KAM is being developed and finalized? Will the schedule of meetings with the auditor accommodate timely discussions?
- Have we requested our auditor to prepare draft KAM wording (based upon the most recently completed audit) for discussion purposes ahead of the required implementation date for KAM reporting in 2020?

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Corporate reporting

The board's due diligence

Significant or unusual transactions and events

IBOR transition

Challenges arising from volatile economic conditions

The board's due diligence

Looking for more guidance?

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Document your review using the notes pages at the end of this guide.

Centre for Financial Reporting

"Have we identified what needs to be done to ensure the financial statements are compliant relevant, and transparent?

Once the board has completed its analysis of the organization's financial statements, some suggested next steps the board may perform to ensure that it meets its due diligence responsibilities are listed below.

Some questions the board may wish to ask:

- If we are not satisfied that the financial statements are compliant, relevant, and transparent, have we identified what needs to be done to ensure the financial statements become so?
- Have we met with the independent auditor to review its assessment of the financial statements?
- Have we inquired as to the processes put in place to enable the CEO and CFO to fulfil their certification obligations?
- Do our minutes document our review process and conclusions regarding the financial statements and other financial filings?
- Have we ensured that the audit committee and management understand the independent auditor's summary of unadjusted misstatements—both quantitative and those related to disclosures—and the impact on controls?

Significant or unusual transactions and events

Looking for more guidance?

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"When an organization experiences a disruptive event that causes changes to the existing corporate structure or operating model, the board should ascertain whether it was properly reported, disclosed, and relevant internal control processes built in.

The board should consider the accounting recognition and disclosure of significant or unusual transactions and events that occurred during the year. This includes any material, non-recurring transactions and events that may be unusual and may require greater prominence in the financial statements. Examples of non-routine transactions include business or asset acquisitions, divestitures, restructurings, debt or equity financings, new business models, and contingent liabilities such as litigation.

Some questions the board may wish to ask:

- What significant or unusual transactions and events took place during the year? Do they correspond to those identified by the board and management? Have these items been properly reflected in the financial statements?
- Has the board assessed the impact of transactions or events on management's internal controls processes?
- Is the board satisfied that the new accounting estimates and judgments made by management take into account any disruptive events experienced by the organization during the year?
- Were there any transactions with related parties and, if so, have they been adequately disclosed?
- Has the organization made any commitments that require disclosure?
- Has the organization entered into any unusual financing arrangements such as securitizations, factoring, or the issuance of debt or equity with unusual terms and/or conversion options? Have these been disclosed in accordance with IFRS?

IBOR transition

Interest rate benchmarks such as interbank offered rates (IBORs) play a key role in global financial markets and index trillions of dollars in financial products. As evidenced by the LIBOR scandal, some IBORs are subject to manipulation, which raises concerns about how these rates were determined. Work is underway in multiple jurisdictions to transition to alternative risk-free rates (RFRs) by 2021. The main goal of using RFRs is to provide more reliable rates.

The upcoming phase-out of IBOR in favour of RFRs should be a priority for any enterprise involved in variable interest rate financial instruments. Boards and management should take action to avoid reputational, legal, and commercial risk, including having an inventory of loans and credit facilities that will be affected by the change and a review of alternative financing means.

There are three steps that management should take to set up an IBOR transition program:

1. **Mobilize a cross-business unit transition program with C-level sponsorship**
   - Given the degree of uncertainty and complexity, IBOR transition is likely to be one of the (if not the) biggest transformation programs many enterprises will undertake. Boards should establish a coordinated, centralized, and senior steering committee to manage and oversee it.
2. **Set out a transition roadmap**
   - An IBOR transition program should include key activities such as identifying financial exposures and defining the approach to transition, as well as switching off LIBOR processes and infrastructure.
   - It is crucial to identify key market and regulatory developments and associated milestones—and to continue to track these.
3. **Identify the risks early**
   - Potential risks related to the transition include: (i) clients' unwillingness to transition, which may result in the continued growth of IBOR exposures; and (ii) the effects on financial performance that may result in shortfalls against financial plans.
   - Management and its counterparties need to agree to solutions for minimizing loss or harm from these risks and ensure that the effectiveness of these solutions is reported to the board.
   - Management should understand the impact of IBOR on disclosure of their financing activities. The following disclosures will be required: the extent of risk exposure that is affected by the reform; how the transition process is being managed; and a description of significant assumptions or judgments made in applying the amendments to IFRS 9 and IAS 39.

Looking for more guidance?

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More on this topic:

LIBOR transition: Setting your firm up for success (Deloitte, 2019)

IFRS in Focus: IASB issues Interest Rate Benchmark Reform amendments to IFRS 9, IAS 39, and IFRS 7 (Deloitte, September 2019)

Centre for Financial Reporting

> "The risks related to the IBOR transition are significant, and the level of scrutiny will continue to grow.

To set up for success, boards should ensure that they have a clear transition roadmap, have identified all relevant risks, and are managing these risks.

Some questions the board may wish to ask:

- Has an IBOR steering committee consisting of sufficiently senior members of management been established? Is it overseen by the CFO or CRO (chief risk officer)? Has the steering committee been instructed to look across the organization as a whole so as to be able to tailor decisions to a given business unit?
- Have we ensured that management has educated senior stakeholders about why it is essential to mobilize and fund a program? Have they engaged with industry working groups and regulators?
- Have we ensured that an inventory of loans and credit facilities that will be impacted by the change has been performed, and that alternative financing means have been reviewed? Is there a strategy for reducing and managing IBOR exposures? Are there plans to document the progress of the transition?
- Have we ensured that our organization has created both client and internal communications strategies? Do our customers understand the risks? Have we rolled out an internal training program so that employees understand when issues need to be escalated?
- Has our organization discussed the impact of the transition on disclosure of its financing activities?
- Has our organization analyzed its contractual language and amended contracts accordingly?

Challenges arising from volatile economic conditions

Looking for more guidance?

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More on this topic:

Economic outlook: Politics aside, growth improves (Deloitte, 2020)

On the board agenda 2020 (Deloitte, December 2019)

Companies need to prepare for the next economic downturn, (Harvard Business Review, April 2019)

Read our quarterly series on trends and events shaping Canadian and International economies.

We are in the midst of a global economic slowdown that threatens to weaken Canada's growth prospects. The modest rate of expansion that is projected increases the possibility that a negative shock could trigger a turn in the business cycle.

Rising tariffs and the increasing politicization of trade policy have sown uncertainty and hit exports. Manufacturing, with its heavy reliance on export sales, has been a conspicuous casualty and output has been slowing sharply. With interest rates at historically low levels, the scope for policymakers to counter weaker growth with monetary stimulus is less than it was on the eve of the last downturn. This means that more of the burden of resisting the downturn is likely to fall on fiscal policy, in the form of increased government spending and tax cuts.

As directors contemplate strategic decisions in the year ahead, resilience will likely become a more commonly used term in the boardroom. And it is crucial to understand the particular vulnerabilities a business would have in a downturn. No two organizations would be affected in exactly the same ways. Businesses that are better positioned to endure the most challenging environments can benefit from a downturn by capitalizing on opportunities that aren't accessible to less prepared competitors. (However, organizations should be aware that they need to be mindful of their response to a downturn and consider market and customer perspectives.)

The traditional blueprint for planning looks too static for the kind of economic reality we now face. Dynamic planning, including scenario planning, is necessary to stay ahead of change and position an organization so that it can quickly resolve challenges or capitalize on opportunities.

Remain calm and approach planning and risk management from a mindset of opportunity. Start thinking now about potential actions that can be executed if economic conditions deteriorate. Understand that inaction or drastic, non-strategic belt-tightening in anticipation of a downturn will only make things worse.

"Remain calm and approach planning and risk management from a mindset of opportunity.

Some questions the board may wish to ask:

- Does the organization monitor its position in relation to financial market volatility? Does the organization's forecast indicate that there is sufficient liquidity considering existing funding arrangements?
- If debt covenants have been breached or are at risk of being breached, have discussions taken place with the lenders to secure waivers where possible? Have these arrangements or risks been appropriately presented (e.g., as current vs. long-term) and disclosed?
- If funding is due to expire within the year, has consideration been given as to whether or not the organization will be able to secure new sources of financing or renew existing funding arrangements?
- Are current market conditions an indicator of impairment or reversal of impairment?

Checklists

- Clarity and completeness of corporate disclosures
- Related information in addition to the financial statements
- Annual information form (AIF)
- Management's discussion and analysis (MD&A)
- Statement of executive compensation

Clarity and completeness of corporate disclosures

Looking for more guidance?

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More on this topic:

Developing a data insights strategy: How to extract value from your data (Deloitte, 2019)

From obligation to opportunity: How companies can transform corporate reporting into an asset (Deloitte, 2019)

CFO Insights – Revolutionizing reporting in the digital age (Deloitte, July 2019)

Revolutionizing reporting in the digital age (Deloitte, June 2019)

Centre for Financial Reporting

At a time when technology is the driving force behind change and growth in the business world, leaders can take advantage of technology in presenting data in a meaningful way for readers of their financial statements. Organizations now have the ability to utilize AI to create innovative processes, tools, and systems they can use to derive targeted business insights and financial value from their data.

Enterprises have been preparing and delivering the same information in the same ways for decades, but traditional corporate reporting formats are not mandatory. Enterprises can be more flexible in how they prepare their corporate reports while still meeting requirements.

Increasingly, they are using digital tools to upgrade their reporting processes to get better information distributed faster. The savings that enterprises can achieve as reporting evolves will be real and sustainable; many will be reducing human labour significantly and delivering reports more efficiently. The potential for value creation from improved reporting is even more promising. And customer demand will drive a reporting overhaul, influenced by self-service persona-based reporting via custom dashboards that generate the most pertinent and accurate information in the shortest amount of time.

The future of reporting will include AI such as chatbots, and the writing of first drafts can be done without the involvement of people. Businesspeople will be able to react to reported information at their own pace via smartphone or tablet, rather than having to look at static data on paper. They'll be able to use interactive tools to gather more information. And automation helps simplify and streamline data management because data used in reporting is prepared with software rather than manually, freeing up analysts to focus on what's hidden or buried in the data.

As always, board members should be certain that all items have been properly disclosed in the financial statements and that these disclosures are consistent with the MD&A.

> "Traditional reporting formats are not mandatory; enterprises can be more flexible in how they prepare their corporate reports.

Some questions the board may wish to ask:

- Are we using plain language in to ensure information is meaningful?
- Has the organization embraced technology to the extent that it can consider using it in financial statements and other corporate reporting?
- How can we increase transparency without compromising information that we wouldn't want competitors to know about?
- When reading the financial statements, do we understand all of the disclosures, especially those relating to complex or non-routine transactions entered into in the current year, or are we left with further questions?
- Have we satisfied ourselves that there is a process to ensure that all required disclosures have been included? Do we know which disclosures management has omitted on the basis that they are not material?
- Is there a process to identify all related parties of the organization, and the transactions, balances, and commitments the organization has entered into with these parties? Has this process identified the transactions and considered whether they were completed under "normal commercial terms" or not?

?

Related information in addition to the financial statements

Looking for more guidance?

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Centre for Financial Reporting

"Do we regularly consider whether the information under review, if known to the investors, would affect their decision to purchase, sell, or hold shares?

Related information in addition to the financial statements might include summary financial statements, continuous disclosure documents (such as Management's Discussion and Analysis or the Annual Information Form) released to the market, public announcements, significant regulatory filings, and offering documents, such as prospectuses.

The board should consider how it will satisfy itself that all information is presented fairly and in a transparent manner. This should include a focus on consistency of information, tone, and messaging across all financial communications.

Some questions the board may wish to ask:

- Do the financial statements and other disclosure documents reflect all of the information previously released in other announcements?
- Do continuous disclosure documents articulate a clear story about the business, its purpose, its value creation framework, and its performance in this regard?
- Is there information that we considered or discussed that could be disclosed to investors and would that information affect the investor's decision to purchase, sell, or hold shares?
- Where financial information is included in public announcements, is the presentation of figures or measures consistent with the way they are discussed in the financial statements (e.g., labelling and measurement) or with the way they will be reported in the subsequent financial statements?
- Have we satisfied ourselves that there is a process to ensure that all regulatory filings are being prepared, approved, and filed appropriately? Have we received a schedule of all regulatory filings required to be filed during the year with a clear description of the purpose and content of each?
- Have disclosures of forward-looking information been reviewed to determine whether revised disclosures are required?

Annual information form (AIF)

Looking for more guidance?

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How does your organization's AIF compare? Try our easy-to-use AIF assessment tool.

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"Based on our knowledge of the organization, are there any significant omissions in the AIF?"

The CSA Form 51-102F2, Annual Information Form, states the purpose of this document:

An AIF is intended to provide material information about your enterprise and its business at a point in time in the context of its historical and possible future development. The AIF should describe the enterprise, its operations and prospects, risks, and other external factors that have an impact on the enterprise specifically.

The disclosures included in the AIF are supplemented by continuous disclosure filings made throughout the year, including news releases, material change reports, business acquisition reports, financial statements, and management discussion and analyses.

Some questions the board may wish to ask:

- Does any disclosure contradict what we know about the organization or what is disclosed in other documents?
- Based on our knowledge of the organization, has any required information been omitted?
- Does the disclosure include both positive and negative news?
- Are the organization, its operations and prospects, risks, and other external factors accurately described?
- Is the focus on material information?
- Is the AIF written in plain language?
- Does the AIF avoid the use of boilerplate text?
- Have we met with management to discuss any findings arising from the board's review? Do we wish to meet with the internal auditors?
- Have we considered comments raised by the independent auditor or legal counsel?

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Management's discussion and analysis (MD&A)

Looking for more guidance?

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More on this topic:

SEC proposes to modernize disclosures of business, legal proceedings, and risk factors under regulation S-K (SEC, August 2019)

Centre for Financial Reporting

The MD&A is an important disclosure document designed to tell the organization's story from management's perspective. This has been a core document required by Canadian and US securities regulators for many years. This document provides the current state of MD&A requirements in both countries and will conclude with some questions that those on the boards of public companies may want to consider.

Canadian Securities Administrators (CSA)

While the CSA is considering amendments to CSA Form 51-102F1, Management's Discussion and Analysis to eliminate duplication between the financial statements and MD&A, the current form states:

The MD&A is a narrative explanation, through the eyes of management, of how your enterprise performed during the period covered by the financial statements, and of your enterprise's financial condition and future prospects. The MD&A complements and supplements your financial statements, but does not form part of your financial statements.

The objective, when preparing the MD&A, should be to improve your enterprise's overall financial disclosure by having a balanced discussion about your enterprise's financial performance and financial condition including, without limitation, such considerations as liquidity and capital resources, and openly reporting bad news as well as good news. Your MD&A should:

- Help current and prospective investors understand what the financial statements show and do not show.
- Discuss material information that may not be fully reflected in the financial statements, such as contingent liabilities, defaults under debt, off-balance-sheet financing arrangements, or other contractual obligations.
- Discuss important trends and risks that have affected the financial statements, and trends and risks that are reasonably likely to affect them in the future, and
- Provide information about the quality and potential variability of your enterprise's profit or loss and cash flow to assist investors in determining if past performance is indicative of future performance.

Securities and Exchange Commission (SEC)

In August 2019, the SEC proposed rule amendments to modernize certain disclosures required by Regulation S-K, specifically those concerning the descriptions of the business, legal proceedings, and risk factors. The proposed amendments released to business and legal proceedings are intended to simplify compliance efforts for registrants, improve disclosures for investors, discourage repetition, and eliminate disclosure of information that is not material. A more detailed description around the changes to the risk factor disclosure requirements are provided below.

When it comes to risk factors, the amendments would:

- Require summary risk factor disclosure if the risk factor section exceeds 15 pages;
- Refine the principles-based approach of the current rule by changing the disclosure standard from the "most significant" factors to the "material" factors that require disclosure; and
- Require risk factors to be organized under relevant headings, with any risk factors that may generally apply to an investment in securities disclosed at the end of the risk factor section under a separate caption.

Organizations are exposed to legal, financial, business, and reputational risks and there is a greater focus on disclosures of these risks than ever before. Organizations can improve their risk disclosures by incorporating information from enterprise risk and internal audit risk assessments.

"Organizations may need to improve their risk assessment process.

Some questions the board may wish to ask:

- Are we up to date and do we fully understand any new or amended disclosure requirements?
- Does the MD&A omit any required information or include any information that contradicts what the board knows about the organization or information included in other documents?
- Does the MD&A include future-oriented information? If so, have we considered whether the assumptions supporting this are reasonable and supportable? Are users alerted to the uncertainty inherent in this information and to the fact that actual results may differ? Has management appropriately updated previously disclosed future-oriented information to take into account actual results and explained the reason for any variances?
- Is the discussion appropriately balanced between positive and negative news?
- Do any non-GAAP measures used comply with regulatory requirements?
- Is the MD&A written in plain language?
- Does it avoid the use of boilerplate text and focus on material information?
- Does the document improve the organization's overall financial disclosure by providing a balanced discussion of the financial performance and financial condition?
- Does the MD&A discuss material transactions giving rise to items such as contingent liabilities, defaults under debt, off-balance-sheet financing arrangements, or other contractual obligations in appropriate detail?
- Does the MD&A discuss trends and risks that have affected the financial statements or are reasonably likely to affect them in the future?
- Does the MD&A provide information about the quality and potential variability of the organization's earnings and cash flow to assist investors in determining if past performance is indicative of future performance?
- Does the MD&A explain how new regulatory and financial reporting requirements may affect the organization? Does the MD&A discuss and analyze any changes in accounting policies made in the current period or that will be adopted in future periods? Does it discuss the expected effect of the change on the financial statements, including the effect on the business?
- Have we met with management to resolve our concerns?
- Should we meet with the internal auditors?
- Have we considered comments raised by the independent auditor or legal counsel?

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Statement of executive compensation

The Canadian Securities Administrators ("CSA") requirement for statements of executive compensation is well known by directors. When it comes to compensation, there are some new developments worth keeping an eye on. One such development is that there may soon be a legal "Say on Pay" requirement in Canada, something that already exists in the United States, the United Kingdom, and many countries in Europe: a requirement to have shareholders vote whether to approve a public company's approach to executive compensation. Currently the practice is voluntary.

Focus on this issue is strong as investors demand more transparency and increasingly stringent proxy advisory firm voting policies. There is heightened scrutiny from investors, especially activist investors, on compensation programs and performance goals. It's more important than ever for enterprises to demonstrate that their executive compensation program is aligned with investors' interests. Enterprises seek shareholder support of 90 percent or higher, according to a September 2019 Deloitte report, "On the board's agenda: Trends in executive compensation;" anything less than that is a warning that the program may be out of line with shareholder expectations.

Another topic getting a lot of attention in the United States since 2018 is the disclosure of pay ratios: the ratio of the CEO's salary compared with their median employees. In Canada, there's no obligation to disclose pay ratios. But a stakeholder approach to executive compensation is gaining momentum and this could affect that large compensation gap. While enterprises have historically served shareholders, in the summer of 2019, the Business Roundtable organization in the United States released a new Statement on the Purpose of a Corporation. It was signed by 181 CEOs of very large companies who committed to leading their enterprises for the benefit of all stakeholders: customers, employees, suppliers, communities, and shareholders. In December 2019, the World Economic Forum released its first manifesto since 1973, built on the same premise of purpose and value creation for all stakeholders.

There is a case to be made that the stakeholder approach leads to business success. For example, by creating value for—through wages, training, and career opportunities—the enterprise cultivates a high-quality, engaged workforce. The workforce, in turn, assures that the enterprise creates an engaged, loyal base of customers who enjoy the fruits of the employees' efforts.

Looking for more guidance?

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More on this topic:

What a stakeholder approach means for executive compensation (Directors & Boards, 2019)

Mandatory 'say-on-pay' may be on the way in Canada (Blakes Business Class, October 2019)

On the board's agenda: Trends in executive compensation (Deloitte, September 2019)

CEO pay-to-employee pay ratio tells us nothing about the competence of the CEO, Fraser Institute (Fraser Institute, January 2019)

How does your organization's executive compensation disclosure compare? Try our easy-to-use executive compensation assessment tool to assess your company's executive compensation disclosure.

Centre for Financial Reporting

> "A stakeholder approach to executive compensation is gaining momentum and this could affect the large pay ratio gap.

Some questions that boards may wish to ask:

- Has the board considered the needs, of not only shareholders, but all stakeholder groups? Have any of these considerations been reflected in the related disclosures?
- Has our compensation committee surveyed its key shareholders and other stakeholders on expectations?
- Has the company disclosed a framework for value creation and is it linked to executive compensation?
- Have we compared our enterprise's pay ratio to that of our peers? If our pay ratio is out of sync, how have we responded in our disclosures?
- Have you voluntarily adopted a shareholders say-on-pay vote? To prepare for possible mandatory say-on-pay rules, have we reviewed the details of our executive compensation program and considered potential impact?
- Has our shareholder outreach sufficiently identified concerns with executive compensation?
- Does the statement of executive compensation clearly communicate the compensation we intended the organization to pay, make payable, award, grant, give, or otherwise provide to each named executive officer and director for the financial year?
- Will the disclosures made in the statement help stakeholders understand how decisions about executive compensation are made?
- Does the statement focus on material information? Have newly adopted changes to compensation plans been appropriately described?
- Is the statement written in plain language? Does it avoid the use of boilerplate text?
- Does the statement include any information that contradicts what is known to the board? Is the discussion well balanced between positive and negative news?
- Have we considered any comments raised by the independent auditor or legal counsel relative to the impact on compensation?
- Have we documented our review of the statement of executive compensation? How does our organization's executive compensation disclosure compare?

Next steps

If you have questions or would like to further discuss any of the matters covered in this report, please contact one of the professionals listed below. Deloitte's professionals have a broad range of expertise and can offer a range of solutions—including technical accounting, governance, or technological solutions—that can be customized to meet your organization's specific compliance needs.

Subject to appropriate independence safeguards and service pre-approval, Deloitte can help your organization ensure that its financial filings are compliant with regulatory requirements.

Let us help design a strategy that can turn the continuous disclosure obligations into value generators for your organization.

For further information, please contact me or one of the Deloitte professionals listed below:

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Beyond compliance

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Notes

Designed by Tracy Tahara.

Acknowledgments

A special thanks to all the professionals who assisted with the drafting, editing, designing, and reviewing of this Alert, including: Donna Graffi-Smith, Bonnie Munday, Diane Ritter, and Anna Rzepkowska.

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[Publication ID 19-6507V]