Quality Management Systems assessments: **Strengthening audit quality**

2020 CPAB Assessment Model Update

The Canadian Public Accountability Board's (CPAB) audit quality assessment program is at the centre of what we do. Fundamental to our regulatory effectiveness, it combines risk-based individual audit engagement file inspections with broader, more holistic evaluations of firmwide quality management systems (QMS). Our current assessments of these systems at select audit firms is intended to accelerate improvements needed to achieve the consistent execution of high-quality audits. Based on learnings from our assessments to date at the country's four largest audit firms, CPAB has evolved its assessment criteria and key concepts which are presented in the Appendix of this document.

Why Quality Management Systems are important

Strong systems of quality control[1] at audit firms is important to achieving consistent execution of high-quality audits. Our mandate and inspection process go beyond the inspection of the audits of selected reporting issuers to include an assessment of the firm's system of quality control in accordance with professional standards and against CPAB's QMS evaluation criteria. Quality management systems support firms as they manage risk, emphasize governance and accountability, and deploy well trained professionals with skillsets appropriate for the circumstances.

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[1] The International Auditing and Assurance Standards Board (IAASB) has proposed to replace the term "system of quality control" with "system of quality management" within the International Standard on Quality Management 1 (ISQM 1). CPAB has used quality management system(s) or QMS with parallel meaning.

QMS evolution

CSQC 1
2009

The current requirements for Canadian audit firms to maintain a system of quality control over key aspects of their operations governing assurance engagements became effective January 1, 2009 under Quality Control for Firms that Perform Audit and Reviews (CSQC 1 [2]). As part of CPAB's inspection of each firm's system of quality control and compliance with CSQC 1, audit firms must demonstrate they have in place policies and procedures that are appropriately designed and implemented to comply with the objectives of the standard.

QMS
Implementation
2017

To accelerate the improvements to QMS at audit firms and drive consistent execution of high-quality audits, CPAB published our QMS assessment criteria in 2017. CPAB's QMS assessment criteria and underlying key concepts were developed to drive firms to implement targeted improvements to the design and operation of systems of quality control that would have the greatest impact on audit quality. We conducted a pilot in 2017 to complete preliminary assessments against CPAB's QMS criteria at two large audit firms. Quality management systems were evaluated at each of the four largest audit firms in 2018. The decision to limit our initial evaluations to these firms was due to the significance of the market capitalization of public companies they audit.

ISQM 1
Exposure Draft
2019

The International Auditing and Assurance Standards Board (IAASB) issued an exposure draft in February 2019 to strengthen the requirements over the systems of quality control at firms. The updated proposed standards, International Standards on Quality Management (ISQM 1) and Engagement Quality Reviews (ISQM 2), move beyond the compliance-based approach to a principles-based approach to the design, implementation and operation of each firm's systems of quality management. This requires audit firms to apply a risk-based approach that includes establishing quality objectives, identifying and assessing quality risks and designing and implementing responses.

QMS
Evaluations
2018-19

During our 2018 and 2019 inspections of Canada's four largest audit firms, we completed evaluations against our QMS assessment criteria. The results of these evaluations are included in our Audit Quality Insights reports published in March 2019 and March 2020. Each of the four largest audit firms have made progress in developing responses to CPAB's QMS model to achieve the objectives of each criteria and underlying key concepts, but the rate of progress has varied significantly among the firms and between each of the CPAB criteria within the firms.

[2] Adopted from International Standards on Auditing set by the IAASB and endorsed by the Auditing and Assurance Standards Board (AASB).

QMS Update 2020

In line with our strategic commitments to enhance our regulatory effectiveness and to drive targeted, systemic changes to accelerate audit quality improvements, CPAB evolved our QMS assessment criteria and underlying key concepts, further described below under **QMS assessment criteria – what's new**.

Starting in 2021, we will complete preliminary evaluations of other select annually inspected firms against CPAB's QMS assessment criteria to drive a quality culture at those firms. For all other annually inspected firms we will assess QMS in conjunction with the firms' implementation of ISQM 1 and ISQM 2.

ISQM 1 Implementation 2022

The proposed standard is expected to be finalized in 2020, with an anticipated 18-month implementation period. It is expected that the final standard released by the IAASB will be endorsed by the Auditing and Assurance Standards Board (AASB), and as such be applicable to all audit firms in Canada. The Public Company Accounting Oversight Board (PCAOB), the US audit regulator, has also released a concept paper for a potential quality control assessment approach based on ISQM 1 and is seeking input on supplemental requirements determined appropriate for firms subject to PCAOB standards. Comments on the exposure draft were due March 2020.

QMS assessment criteria – what's new

Our updated QMS assessment criteria takes into consideration knowledge gained through our evaluation from the past two inspection cycles of the four largest audit firms' QMS responses, which included a combination of controls and processes, and developments in the finalization of ISQM 1 and ISQM 2. The revision of CPAB's QMS assessment criteria and related key concepts achieves these key objectives:

Streamline the QMS assessment criteria and related key concepts.

- We combined talent management and resource management into a single criterion which is more aligned with ISQM 1 and more reflective of how the firms manage their operations.
- We combined key concepts that addressed similar quality objectives.
- We removed key concepts that did not fully align to the objectives of ISQM 1.

Provide clear, consistent and understandable language.

- We clarified that evaluation, escalation, intervention and resolution must be demonstrated to address the quality objectives of the QMS assessment criteria.
- We used generic language to acknowledge the difference in the firms' organizational structures.
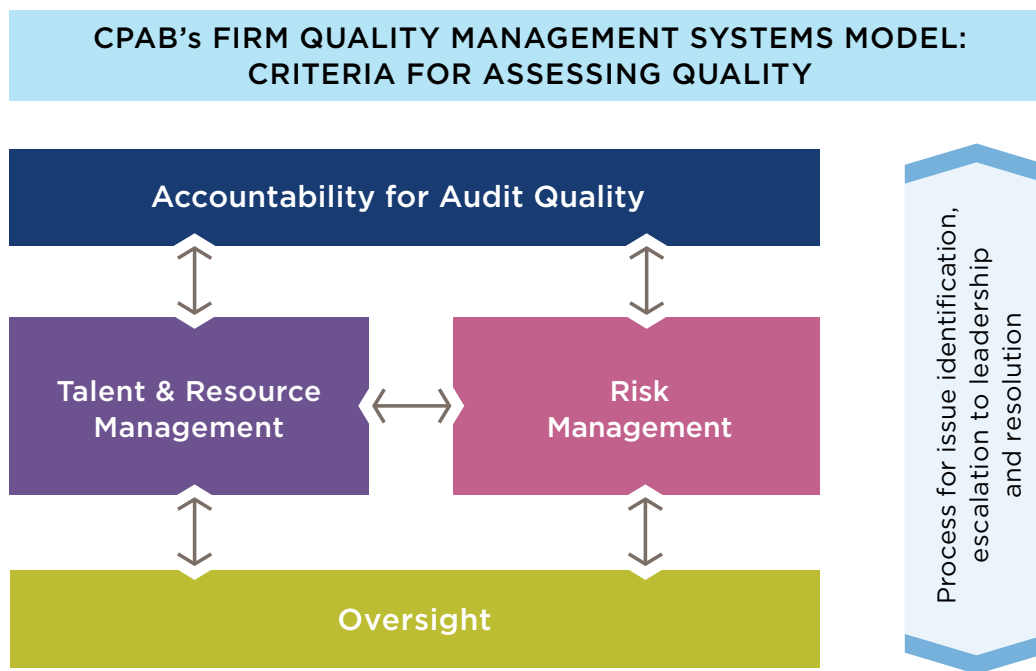
Retain the core quality objectives of the QMS assessment criteria, without incorporating incremental requirements of ISQM 1.

- We will continue to assess the firms' compliance with CSQC 1, the standard that currently requires firms to maintain a system of quality control and the foundation that supports the QMS quality objectives.
- We will continue to monitor developments in the finalization of ISQM 1 and ISQM 2 and the firms' ISQM 1 and ISQM 2 readiness through understanding both global and local initiatives.

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Quality Management Systems Assessment Model

We will continue to evaluate the firms' assessments of organizational structures, accountabilities and operational controls and processes supporting audit quality. The model for assessing quality will concentrate on four criteria: accountability for audit quality, risk management, talent & resource management, and oversight. Processes for issue identification, escalation to leadership and resolution are key attributes for each of the criteria.
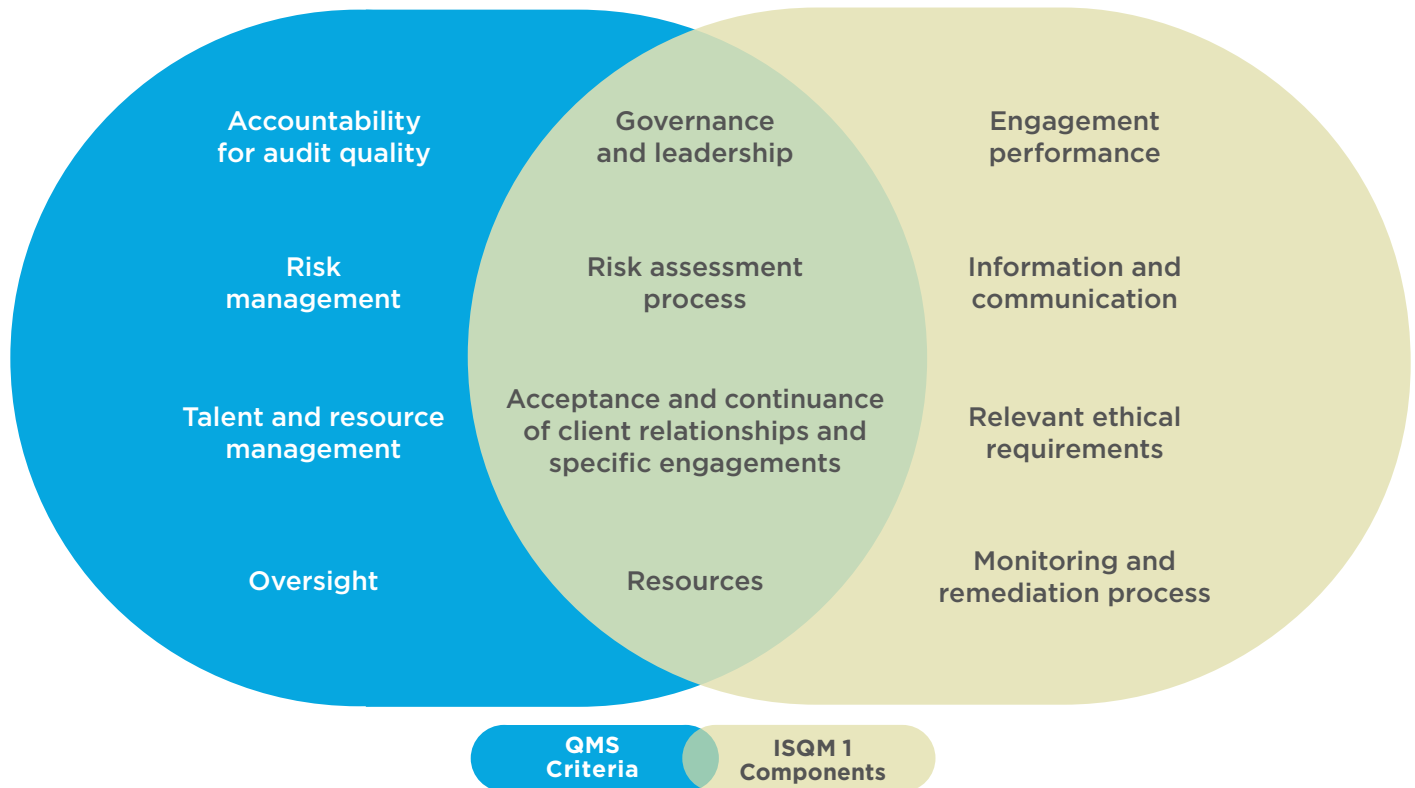
**CPAB's FIRM QUALITY MANAGEMENT SYSTEMS MODEL:
CRITERIA FOR ASSESSING QUALITY**

Accountability for Audit Quality

Talent & Resource Management	Risk Management

Oversight

Process for issue identification, escalation to leadership and resolution

The Appendix: **Quality Management Systems Criteria/Key Concepts** expands on the quality objectives of each of the criteria including the revised key concepts to aid in the understanding of the operational controls and processes CPAB will focus on in future inspection cycles.

Our assessment criteria were never intended to fully encompass ISQM 1. Instead, QMS assessments focus on the areas of the firms' system of quality management that will have the greatest impact on audit quality.

CPAB's QMS model is aligned with the expected future components of ISQM 1 in several key areas. In addition, the risk assessment process under the proposed standard requires the firms to identify and respond to quality risks, similar to the process required by the firms to address the QMS criteria. The four ISQM 1 components (engagement performance, information and communication, relevant ethical requirements, and monitoring and remediation processes) not specifically addressed in the CPAB QMS model will continue to be evaluated under the existing CSQC 1 standard where relevant. All firms are required to fully comply with ISQM 1 and CPAB will evaluate the firms' compliance with the proposed standard when it becomes effective.

CPAB QMS assessment criteria and ISQM 1 components[3]

Accountability for audit quality	Governance and leadership	Engagement performance
Risk management	Risk assessment process	Information and communication
Talent and resource management	Acceptance and continuance of client relationships and specific engagements	Relevant ethical requirements
Oversight	Resources	Monitoring and remediation process

QMS Criteria   **ISQM 1 Components**

QMS evaluation

The firms are expected at least annually to evaluate their response to CPAB's QMS model, which includes a combination of controls and processes to address the quality objectives of each criteria and underlying key concepts. The firm's evidence to support its evaluation against CPAB's QMS model is expected to include the following:

- A narrative that summarizes the firm's processes and controls.
- Evidence to support the firm's testing of the design and operating effectiveness of the firm's controls that address the quality objectives.
- Identification of gaps and process improvement observations regarding the design and operating effectiveness of the firm's controls, including an action plan to remediate these matters.
- As part of the firm's root cause analysis over significant inspection findings, from both internal and external reviews, an assessment of whether they are indicative of potential weaknesses in the firm's system of quality controls.
- Evidence to demonstrate ongoing monitoring performed to ensure the firm's response to CPAB's QMS model remains appropriate.

[3] Based on the exposure draft of ISQM 1 issued by the IAASB.

CPAB considers whether the firm's response to CPAB's QMS model addresses the quality objectives of each criterion and underlying key concepts. Our assessment considers the nature, timing and extent of the firm's responses and how they reflect the nature and circumstances of the firm (e.g. has the firm considered the frequency of the control in relationship to the significant audit cycles of the firm's portfolio of public company audit clients).

Once our assessment is complete, ratings are assigned as defined below.

Acceptable

The firm's quality management system is appropriately designed, implemented and operating effectively to respond to CPAB's assessment criteria.

Acceptable with opportunities for enhancement

Opportunities exist to enhance specific areas of the firm's quality management system and require corrective action to effectively respond to CPAB's assessment criteria. All key aspects of the firm's quality management system are designed and operating effectively throughout the year.

Needs improvement

Identified deficiencies are isolated to specific areas of the firm's quality management system and require corrective action to effectively respond to CPAB's assessment criteria. Certain key aspects of the firm's quality management system are absent, inappropriately designed or not operating effectively.

Requires significant improvement

There are systemic deficiencies in the firm's quality management system that require substantial and corrective action to effectively respond to CPAB's assessment criteria. Significant aspects of the firm's quality management system are absent, inappropriately designed or not operating effectively.

Communicating the results

CPAB will continue to provide our assessment of audit quality and recommendations for enhancement in our confidential firm inspection reports. The firm reports now contain three sections that communicate our findings and recommendations based on our file inspection activity, QMS assessments, and other quality control findings, including independence.

Our Audit Quality Insights reports will continue to provide stakeholders with an overview of the file inspection activity and commentary on QMS, including the importance of these controls to support the consistent execution of high-quality audits. We will provide ongoing communications regarding our assessment of audit quality and the effectiveness of systems in supporting audit quality by providing common themes on findings without disclosing firm-specific details. We will also identify specific topics and best practices relevant to quality environments that audit committees should discuss with their auditors. We hope these discussions will be valuable to those charged with governance in evaluating their engagement teams and the overall support firms provide to individual engagement teams.

Best practices

Firms continue to invest time and resources to address gaps identified through our 2019 QMS assessments and prepare for the effective date of ISQM 1. We have identified the following best practices that will be relevant to firms implementing QMS and ISQM 1, and may be helpful for audit committees to engage with firms to obtain an understanding of their progress and what they are doing to ensure the execution of high-quality audits on a consistent basis.

- Critical assessment of how responsibility and accountability for audit quality are delegated and managed, including ensuring that those with leadership responsibilities have the ability, capacity, support and authority to fulfil their responsibilities.

- Firm leadership roles and responsibilities are designed and communicated, including measurable key performance indicators integrated into the performance evaluation system to hold firm leadership accountable.

- Use of independent practice partners and staff with experience in control implementation and testing to support the development of robust process documentation (including narratives and flowcharts) and testing of the design and operating effectiveness of identified key controls.

- Use of documentation templates to evidence the testing performed by the firm that were developed based on the firm's existing templates for testing controls in an audit.

- Appropriate consideration of the objectives of the CPAB criteria to identify new controls and modifications to existing controls to ensure the quality objectives are fully addressed. In many cases, information to address the quality objectives was readily available.

- Control owners are made aware of the importance of maintaining evidence to demonstrate the control has occurred based on the expected frequency, significant judgments, and actions taken to ensure issues were resolved or escalated to the appropriate levels of leadership, as applicable.

- Designing controls that are iterative and demonstrate active collaboration and information sharing among firm leadership, risk and talent and resource management to ensure that issues are identified, resolved and escalated as appropriate.

- Timely testing and self-evaluation of the design and operating effectiveness of the firm's responses to address the objectives of each CPAB QMS criteria and underlying key concepts, including proactive identification and responses to gaps and process improvement recommendations for remediation.

Appendix:
Quality Management Systems Criteria/Key Concepts

Criteria 1	Accountability for Audit Quality
	Responsibility and accountability for audit quality is clearly defined, delegated and monitored across firm leadership.

Key concepts	**1.1:** Evaluate how responsibility and accountability for audit quality, including key performance indicators, are delegated and communicated within the firm including national and regional leadership, functional areas, engagement partners, engagement quality reviewers and experts.
	1.2: Evaluate how delegated responsibilities and accountabilities for audit quality are executed, measured and reported throughout the year.

Criteria 2	Risk Management
	Client and audit risk are identified and effectively measured, monitored and responded to.

Key concepts	**2.1:** Evaluate how the firm identifies all aspects of client risk that could impact the firm, including audit risks (e.g. through independent review and risk monitoring of SEDAR filings, media reports, changes in market capitalization, deal alerts, etc.) to review and challenge client acceptance and continuance decisions, including the overall client risk rating.
	2.2: Evaluate how the firm identifies, responds and escalates to leadership, where appropriate, changes in risks in the firm's portfolio of audit clients throughout the audit cycle.
	2.3: Evaluate how the firm identifies and tracks high risk engagements, including ongoing monitoring and escalation to leadership, where appropriate.

Criteria 3	Talent and Resource Management
	Competency and capacity at all levels of talent, including experts, is proactively aligned to address changing needs, priorities and risks.

Key concepts

3.1: Evaluate the budgeting of audit hours required to service the firm's anticipated portfolio of audit clients by location and resource level, including experts, to identify and resolve resource shortfalls at the firm level on a timely basis.

3.2: Evaluate the challenge of audit hours forecasted by engagement teams, including comparison to prior year actuals adjusted for anticipated changes to identify and resolve shortfalls at the engagement level on a timely basis.

3.3: Evaluate how the firm monitors individual workload assignments (at all levels, including experts) for changes in chargeable and non-chargeable responsibilities throughout the year, including escalation to leadership, where appropriate.

3.4: Evaluate how the firm monitors its overall client portfolio risk to ensure it matches competency (at all levels, including experts) to client needs and requirements (e.g. having resources with the appropriate skills, experience and training in place based on the client risk profile, including escalation to leadership, where appropriate).

3.5: Evaluate how the firm defines, proactively monitors and responds to excessive hours (at all levels, including experts) throughout the year, including escalation to leadership, where appropriate.

Criteria 4	Oversight
	Leadership has visibility on the progress of audit work and changes in risk to initiate proactive issue resolution.

Key concepts

4.1: Evaluate how leadership monitors the progress of the firm's portfolio of audit engagements to identify delays that require intervention and ongoing oversight to support engagement teams.

Examples of monitoring include:
- Key audit milestones relative to established timelines throughout the audit cycle.
- Significant delays in the receipt of requested client deliverables.
- Number of uncompleted and/or unreviewed working papers against completion dates or client reporting deadlines.
- Incurred engagement hours of senior team members against budgeted hours.

4.2: Evaluate how the firm identifies and monitors material changes in engagement scope, risk or other matters where intervention may be required by leadership for risk management and talent and resource management.

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