

# CPAB Audit Quality Insights Report: 2021 INTERIM INSPECTIONS RESULTS

The Canadian Public Accountability Board (CPAB) provides regulatory oversight of firms that audit the annual financial statements of Canadian reporting issuers. This report provides a snapshot of themes and insights from our 2021 audit quality assessment work to date. We highlight our observations on the impact of the COVID-19 pandemic on public company audits, and our inspection results specifically related to the implementation of the new estimates standard<sup>1</sup> for 2020 audits. We've also included overall considerations for audit committees as year-end audit preparations begin.

**CPAB welcomes the opportunity to discuss this report with audit committees and other capital market participants.**

<sup>1</sup> Canadian Auditing Standard (CAS) 540 (Revised) - *Auditing accounting estimates and related disclosures* effective for years beginning on or after December 15, 2019.



# Audit quality assessments

## Engagement file inspections

CPAB has continued to perform our 2021 engagement file inspections remotely; to date we have completed 73 of 75 planned file inspections across Canada's four largest public accounting firms and identified significant findings<sup>2</sup> in five of those files. This compares to six significant inspection findings across 72 inspections in 2020. All four firms had fewer than 15 per cent of files with significant findings. CPAB has a target of no more than 10 per cent of files inspected with significant findings.

We also completed the balance of our 2020 engagement file inspections for non-annually inspected firms in the first quarter of 2021. We inspected five audit files and identified significant findings in two of these. The remaining inspections for annually and non-annually inspected firms will be completed later this fall and reported on in our annual report in March 2022.

## Enforcement actions

In March 2021 we reported that further regulatory intervention at annually inspected firms with unacceptably high levels of significant findings would be decided upon this year. Restrictions, requirements and/or sanctions were imposed on five annually inspected firms.

Requirements, restrictions and sanctions imposed by CPAB are specifically tailored case-by-case depending on the nature of violations identified during an inspection or investigation. Escalation of CPAB's enforcement actions will increase in proportion to the seriousness of the violation(s) which may include restrictions on a firm's practice, assignment of an external monitor or reviewer to oversee the firm's compliance with professional standards or termination of a firm's ability to conduct public company audits.

## Firm system of quality management

Our 2021 quality management systems (QMS) assessments<sup>3</sup> are currently underway for the four largest firms; we will publish our findings in our annual report in March 2022. Preliminary indications are firms have continued to make progress in developing or refining controls to respond to deficiencies identified in 2020. They have also updated controls and processes to respond to additional quality risks resulting from the pandemic such as lowering thresholds that trigger follow-up or escalation and increasing the frequency of certain key controls. We will evaluate a fifth annually inspected firm against CPAB's QMS assessment criteria during this inspection cycle.

<sup>2</sup> Significant findings — A significant inspection finding is defined as a deficiency in the application of generally accepted auditing standards related to a material financial balance or transaction stream where the audit firm must perform additional audit work to support the audit opinion and/or is required to make significant changes to its audit approach. CPAB requires firms to carry out additional audit procedures to verify there was no need to restate the financial statements due to material error, or to substantiate that they had obtained sufficient and appropriate audit evidence with respect to a material balance sheet item or transaction stream to support their audit opinion.

<sup>3</sup> CPAB issued updated QMS assessment criteria and key concepts in our June 2020 publication [Quality Management Systems assessments: Strengthening audit quality](#) to drive firms to implement targeted improvements to the design and operation of their systems of quality control.

We are also monitoring firm implementation plans for the new quality management standards<sup>4</sup> which require firms to have their system of quality management designed and implemented by December 15, 2022. CPAB expects firms to have controls and processes in place to monitor the progress and changes in the risks of individual engagements to enable firm leadership to provide support as needed.

Critical areas of focus for the firms as they adopt the new quality management standards include:

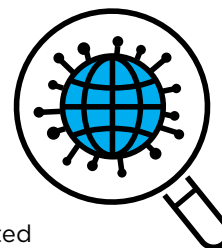
**Risk assessment:** Firms need to design and implement their risk assessment process as soon as possible (if they have not already done so). This process establishes quality objectives and identifies and assesses quality risks so that appropriate responses can be designed and implemented.

**Culture and governance:** Firm tone at the top is critical to establishing an environment that supports the system of quality management and reinforces the firm's role in serving the public interest by consistently performing quality audits. CPAB strongly encourages firms to evaluate their culture and governance to identify barriers to achieving quality objectives. This should include gathering input from all staff levels in a way that encourages open and honest feedback.

**Sufficiency of resources:** Some firms report difficulties attracting and retaining top talent. It will be important for firms to assess the potential risks this may have on achieving audit quality, including risks related to financial and operational priorities, to ensure such risks are identified and appropriate responses can be designed and implemented.

Continued focus on designing and implementing strong quality management systems will be critical to long-term audit quality and supporting firm resilience during times of change.

## COVID-19 and audit quality



As the global pandemic persists in 2021, economic uncertainty and varying levels of lockdown measures remain as well, impacting business and the audit in unprecedented ways. A significant impact on the quality of audits is the increase in estimation uncertainty. We also provide our observations on performing audits remotely.

### Auditing accounting estimates: higher estimation uncertainty

The current economic environment has increased the level of estimation uncertainty on critical accounting estimates, including going concern assessments/liquidity evaluations, complex valuations, impairment evaluations and estimating expected credit losses. The audit work over accounting estimates continues to be an area with deficiencies and opportunities for improvement. Similar to the issues highlighted in our 2020 annual report, the most common inspection findings were related to auditing estimates involving significant assumptions and judgments about future conditions or events.

While we have observed some improvements, there is still more work to be done. We published [Auditing accounting estimates: Strengthening audit quality](#), a communication to all audit firms registered with CPAB in September 2021 with more detail on the nature of the deficiencies, CPAB's expectations and the practices observed in audit files with no inspection findings.

Interactions among the auditor, management and those charged with governance is critical. This includes effective two-way communication with the audit committee and clear evaluation and communication of deficiencies identified over the design and implementation of controls that address areas of higher risk.

<sup>4</sup> Canadian standard on quality management (CSQM 1), *quality management for firms that perform audits or reviews of financial statements, or other assurance or related services engagements*, CSQM 2, *engagement quality reviews* and CAS 220, *quality management for an audit of financial statements* is collectively referred to as the new quality management standards. The effective date for CSQM 2 and CAS 220 is for audits and reviews of financial statements for periods beginning on or after December 15, 2022.

## Performing audits remotely

Most audit firms have conducted at least some if not all aspects of audits remotely in 2021. Some of our preliminary observations on the impact of remote audits include:

- **Guidance/support:** Engagement teams that used COVID-19 guidance, tools and templates generally had good evidence to support their understanding of the impact of the pandemic on the reporting issuer, the industry more broadly and judgments related to the modification or design of further audit procedures to address risks identified.
- **Inventory:** For companies with material inventory, engagement teams attended inventory counts in person where possible. For the limited number of engagements where inventory counts were attended remotely, most engagement teams considered the additional risks and designed further audit procedures to address those risks.
- **Fraud:** Fraud risks identified by engagement teams were often limited to presumptive fraud risks required by the auditing standards associated with revenue recognition and management override of internal controls. While engagement teams considered the impact of COVID-19, incremental fraud risks were identified in very few cases. We also observed instances where fraud inquiries were conducted either by email or by telephone, a much less rigorous practice than interviews held in person or by video conference. CPAB continues to monitor the impact of fraud and other current and emerging issues related to COVID-19 on public company audits. Our publications on the audit implications of COVID-19 are available at [www.cpab-ccrc.ca/insights/covid-19](http://www.cpab-ccrc.ca/insights/covid-19).

## Using technology in the audit

CPAB has seen an increase in the use of automated tools and techniques in the files we've selected for inspection. Auditors are increasingly leveraging technology to perform risk assessment procedures and further audit procedures (i.e., tests of controls and substantive procedures). As the use of these tools expands, we are starting to see them applied to audit more complex areas. CPAB will publish our observations on the use of technology in early 2022.

Our publication **CPAB Exchange: Technology in the audit** discusses the opportunities and emerging challenges provided by technology and CPAB's expectations of auditors.

## How CPAB chooses files to review

CPAB's risk-based methodology for choosing files (and the specific areas of those files) for inspection is not intended to select a representative sample of a firm's audit work. Instead, it is biased towards higher-risk audit areas of more complex public companies or areas where the audit firm may have less expertise. As a result, there is a greater likelihood of encountering audit quality issues. Our inspections do not look at every aspect of every file and are not designed to identify areas where auditors met or exceeded standards. Results should not be extrapolated across the entire audit population, but instead viewed as an indication of how firms address their most challenging audit situations.

## How firms respond to CPAB findings

Most of the significant findings require the firm to carry out additional audit procedures to determine the need, if any, to restate the financial statements due to material error. The remaining findings require firms to add evidence to the audit file to show they had obtained sufficient and appropriate audit evidence with respect to a major balance sheet item or transaction stream.

CPAB expects firms to remediate file deficiencies before their reporting issuer's next quarterly report. Where a restatement is required, the firm is expected to work with the reporting issuer to issue the restatement as soon as possible. To date, no restatements have been required from matters arising from this year's inspections.

Audit firms that voluntarily participate in the Protocol for Audit Firm Communication of CPAB Inspection Findings with Audit Committees (Protocol) share this report and public company specific findings and remedial action taken with the reporting issuer's audit committee. CPAB encourages audit committees to discuss this report and specific findings, if applicable, with their auditor.

## 2021 CPAB disclosures public consultation

CPAB launched a public consultation to request input into potential changes to the information that we disclose about the results of our regulatory assessments, specifically:

1. **Communication to audit committees.**
2. **Disclosure of the results of our regulatory oversight activities.**
3. **Disclosures related to CPAB's enforcement actions.**

The comment period closed on September 30, 2021 and we are reviewing the responses received.

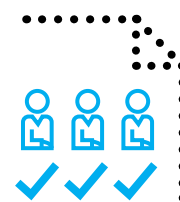
**For more information visit [www.cpab-ccrc.ca/insights/disclosures](http://www.cpab-ccrc.ca/insights/disclosures).**

## Access to audit working papers outside Canada

Certain foreign auditors or jurisdictions continue to prevent CPAB from inspecting audit work of Canadian public companies conducted in those countries. We are concerned about the potential impact of this on auditor oversight, integrity of financial reporting and, ultimately, the investing public. With CPAB's assistance the Canadian Securities Administrators have tabled proposed amendments to National Instrument 52-108 and the Companion Policy 52-108 (Auditor Oversight) which, if passed, will assist CPAB in accessing audit work performed outside of Canada. CPAB anticipates the proposed amendments will come into force in 2021.

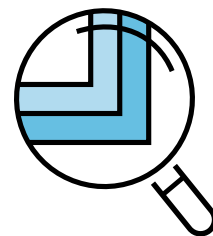
**For a detailed list of jurisdictions where CPAB has been unable to access audit working papers, please visit [www.cpab-ccrc.ca](http://www.cpab-ccrc.ca).**

# Considerations for audit committees



CPAB welcomes the opportunity to discuss this report with audit committees. Below are some areas for audit committee consideration.

Issue	What to ask the auditor
<b>Auditing accounting estimates: higher estimation uncertainty</b>	<ul style="list-style-type: none"><li>• Did the auditor identify any deficiencies or gaps in management’s analysis of significant estimates? If so, how was the impact of these deficiencies on internal control evaluated?</li><li>• How did the auditor evaluate for management bias in auditing complex estimates? Were there any potential indicators identified and how were these resolved?</li></ul>
<b>Performing audits remotely</b>	<ul style="list-style-type: none"><li>• What parts of the 2021 audit does the auditor expect will be performed remotely?</li><li>• Does the auditor plan to conduct fraud inquiries and/or audit of items subject to higher levels of management bias in person or by video?</li></ul>
<b>Use of technology in the audit</b>	<ul style="list-style-type: none"><li>• Is the auditor sufficiently leveraging automated tools and techniques to enhance the quality of audit evidence obtained in the audit?</li><li>• Is the auditor’s use of technology keeping pace with audits of similar companies in the same industry?</li><li>• Are there barriers (e.g., outdated information systems, lack of information technology resources to retrieve the data required, etc.) that are preventing auditors from using technology in our audit?</li></ul>
<b>Access to audit working papers outside Canada</b>	<ul style="list-style-type: none"><li>• What is planned this year in the oversight of component auditors? Are site visits planned? How will audit working papers be reviewed?</li><li>• Do you foresee any countries where significant components are located where it may be difficult to provide CPAB with access to the group auditor working papers?</li></ul>



## Additional CPAB resources

Additional resources related to CPAB's regulatory oversight activities are available at: [www.cpab-ccrc.ca/insights](http://www.cpab-ccrc.ca/insights).

## About this report

This report provides insights from CPAB's interim audit quality assessments for 2021 (related for the most part to the country's four largest public accounting firms). We will publish our annual audit quality insights report in March 2022.

## About CPAB

Charged with protecting the investing public's interests, CPAB oversees public accounting firms that audit Canadian reporting issuers. We promote sustainable audit quality through proactive regulatory oversight, dialogue with domestic and international stakeholders, and practicable insights that inform capital market participants.

To learn more visit  
[www.cpab-ccrc.ca](http://www.cpab-ccrc.ca)

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